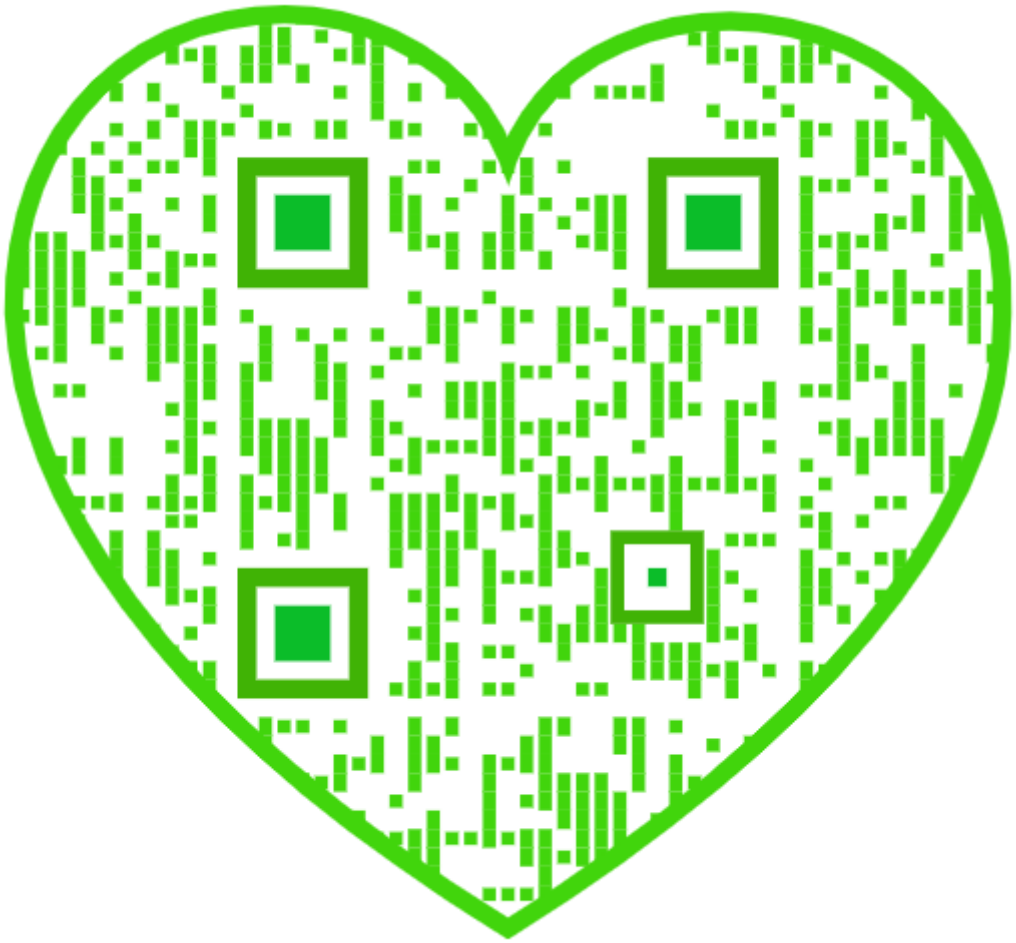

Banking Problems

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THE PROBLEM BEFORE THE NATIONAL MONETARY COMMISSION

By Honorable A. Piatt Andrew,
Assistant Secretary of the Treasury and Special Assistant of the National Monetary Commission, Washington, D. C.

About three years ago most of us found ourselves in a country where business was conducted by curious methods. It was a large and prosperous country whose people had long prided themselves upon their achievements in business and upon the superiority of their commercial and financial equipment, yet, singularly enough, in all of the leading cities of the country coin and legally authorized currency circulated at a premium, while the usual means of payment were inconvertible notes issued without any sanction of law by banks, railroads, mining companies and other firms. At the time of which I write, conditions had reached such a state of demoralization that any one who had a payment to make and felt so inclined, issued notes instead of paying cash. These notes in a majority of cases offered no promise of immediate redemption; in the case of some issues they frankly stated that they would only be repaid when the issuers deemed it advisable; in other cases they stated that due notice of redemption would be given in the daily papers; occasionally they purported to be payable to Richard Roe or John Smith, or some other fictitious character; but ordinarily they were launched with the simple statement that they would be received by their issuers and certain other affiliated firms. I made a collection at that time of nearly two hundred different varieties of this peculiar currency and as the occasion will probably never again occur when such a collection of private, illegal, irredeemable paper money can be made in any highly developed country, I anticipate that my collection will not improbably become in the future an object of curiosity and value. I have several times had occasion to show samples of the collection to European bankers, and have found that they excited much curiosity, for nothing like them has been seen elsewhere than in this country for the greater part of a century.

There were no less than twenty-five thousand banks in the

country under consideration, but the majority of them had suddenly curtailed the facilities which they usually extended to the public. It was in the autumn months just as bountiful crops, vastly exceeding in amount those of any other country in the world, were being brought to market, but on account of the peculiarities of the banking system these crops could only be marketed with the greatest difficulty and at a heavy loss. The 25,000 banks were so singularly unrelated and independent of each other that the majority of them had simultaneously engaged in a life and death contest with each other, forgetting for the time being the solidarity of their mutual interests and their common responsibility to the community at large. Two-thirds of the banks of the country had entered upon an internecine struggle to obtain cash, had ceased to extend credit to their customers, had suspended cash payments and were hoarding such money as they had. What was the result? During a season when nature was offering plentiful harvests, farmers and dealers in produce were refused credit to handle their crops at the very moment when credit was indispensable, and when they had every reason to expect that it would be granted. The owners of factories which had hitherto been working overtime were now for a similar reason obliged to close them down. Railroads which had been running to their utmost capacity suddenly found themselves burdened with idle cars. Thousands of men were thrown out of work, thousands of firms went into bankruptcy, and the trade of the country came to a standstill, because the credit system of the country had ceased to operate.

Such singularly crude forms of inconvertible paper money and such general disorganization in the banking arrangements an uninformed foreigner would doubtless assume must have been the result of a disastrous war. He would imagine that such a situation could only have arisen as news of defeat after defeat had terrified men out of their reason and made them despair of the survival of law and government, but this was not the case. There was no disastrous war, nor had there been any threat of war. There was not the remotest hint of political revolution, nor were there disruptive labor troubles. There had been no conflagrations or national catastrophes. There was no explanation of the condition of the country's business in the political, industrial and physical events of the time.

Unfortunately it is not necessary to mention the name of the

country whose discreditable conditions I have been describing. No property holders in America would mistake the description for a picture of conditions in Central America or the Philippines, however glad he might be to be able to do so. We do not regard the United States as still undeveloped in most respects, or as poorly equipped with the institutions and arrangements of civilization, and yet the collapse of our currency and banking arrangements which I have described was not a unique experience in this country's history. Similar conditions have occurred here before not infrequently and they have similarly been without any visible cause. In 1893, and twenty years before that, in 1873, and intermittently during the earlier phases of the country's history, as well as in 1907, a majority of the banks have suspended payments, inconvertible and illegal paper money has taken the place of coin and legal tender and the business of the country has been brought to an abrupt and disastrous halt.

Yet in none of the leading countries of Europe during the past hundred years, except in periods of war and revolution, has there been any such general collapse of credit and general suspension of the banks as that which I have been describing. In England one has to go back to the period of the Napoleonic wars to find such a premium on money as was witnessed in this country in November and December of 1907. In Germany no such suspension of payments and premium upon money has occurred since the German Empire was founded, nor, so far as I know, among the German states for a long time before. In France, even during the troubled years from 1870 to 1873, when the country was overwhelmed with one catastrophe after another, including the war with Prussia and the Commune and the payment of the Great Indemnity, the premium on coin was only on one occasion as high as was the premium on money in New York for several months in the quiet autumn of 1907.

I do not mean to imply that there has not been in these countries an unceasing alternation of trade activity and trade relaxation. There have been fat years and lean years in every country ever since Adam delved and Eve span. Nor do I mean to imply that there have not been great failures of banks and business firms of all sorts. They will not cease to occur until human honor and human judgment and knowledge cease to have bounds. In Great

Britain powerful banks have failed, like the firm of Overend Gurney in 1866, the Bank of Glasgow in 1878, or the Baring Brothers in 1890. In France great banking firms have gone to the wall, like the Union Generale in 1882, and the Comptoir d'Escompte in 1899. In Germany there have been great financial bankruptcies like that of the Leipziger Bank in 1901. The essential and impressive fact, however, is this, that upon all of these occasions there has been leadership and the situation has been kept firmly in hand; there has been no infectious panic and no general rout in which innocent and guilty alike were crushed to earth; the failures in each of these cases have been confined for the most part to the persons and firms who had been responsible for previous excesses.

It was on account of this striking contrast between experiences here in America and conditions abroad that the National Monetary Commission, in undertaking its investigation of possible means for improving the credit arrangements of this country, began by examining the banking institutions, customs, and regulations of the leading countries of Europe. If among other people in most respects not unlike ourselves, financial panics do not occur and the credit systems maintain themselves intact in the face of stress and strain, then the reasons for that difference require examination. In the summer of 1908, shortly after the appointment of the commission, several of its representatives visited England, France and Germany, the three countries of Europe in which conditions most closely resemble our own, examining their banking systems by personal interviews with the directors and managers of the leading banks and arranging for the preparation of papers and monographs by the leading authorities of those countries. Since then representatives of the commission have also been deputed to investigate the banking systems of most of the other leading countries, including Canada, Scotland, Belgium, Sweden, Switzerland, Italy, Russia, Mexico, and Japan.

In all of these countries the liveliest interest in the work of the commission was manifested. It was borne in upon us time and again that our problem was a world problem, and that Europe and the rest of the world had suffered from the consequences of the American panic of 1907 only slightly less than America herself. I remember an interview in London during the summer of 1909 with a representative of the Bank of Sweden, who told us how even in

his country, which seems to be fairly disconnected from our own, business had suffered long and heavily from the American panic of 1907, and I recall also in this connection a dispatch from Signore Luzzatti, now Prime Minister of Italy, whom we had invited to prepare a paper upon banking conditions in Italy, and who cabled back that he would be very happy to contribute to the work of the American Monetary Commission, upon which, as he believed, the monetary peace of the entire world depended.

For two years the commission has been collecting material concerning the banking systems of the more important countries. The leading financial editors, bankers, government officials and university professors in Europe and America, and even in the Orient, have contributed to the commission's publications, which constitute a library of more than forty volumes. The publications of the National Monetary Commission thus furnish an unparalleled opportunity for those who are interested in American financial problems to make a comparative study of conditions and experiences here and abroad. The public and Congress are equipped to-day as they have never been before in the case of any other great problem, with the most expert knowledge which the whole world has to offer.

No one can foresee what the commission may eventually agree to propose, but without in the remotest manner pretending to indicate what they are likely to recommend, it may not be inappropriate to direct attention to some of the respects in which the banking arrangements of European countries differ from our own. Not because any one believes that we ought to adopt, or that we could adopt in this country, the specific arrangements of any other country, but because the experiences of the older world may possibly yield some general suggestions which can be modified and adapted to our own peculiar conditions. This is easily done, and in the remaining pages I shall accordingly direct attention to certain broad and general features in which the banking practices and regulations of all European countries coincide, and in regard to which banking arrangements in America are peculiar.

First of all, the American observer is sure to be impressed by the fact that the banks of European countries form parts of a coherent system, subject in a greater or less degree to common leadership. No matter what country you have in mind, whether a

monarchy or a republic, you will invariably find some sort of an institution which, on account of its preponderant capital, its peculiar privileges, its relations to the government, or on account of the recognized disinterestedness of its policy, is able to exert a controlling influence over the other banking institutions. Its officers are recognized guardians of the country's credit. They survey conditions with an eye cast beyond the immediate future, and with a regard directed not merely to the prosperity of one section, but to the growth and development of all sections of the country. If credit seems to be expanding feverishly at certain times or in certain lines, their influence is directed to impede excessive advance. If a safely managed and solvent bank finds itself in temporary difficulties owing to conditions which it could not have foreseen or guarded against they will render assistance until the strain is relaxed, and if, because of an unexpected catastrophe the confidence of the community tends to be unsettled, they are able to prevent the disorder from spreading. Such leading and influential institutions, organized not with the primary object of obtaining dividends for their stockholders, but organized and managed to support the public credit and the common interests of the country, play a predominant rôle in the banking organization of every European nation. Their functions and the details of their organization differ from one country to another, but they coincide in the facilities which they extend to other banks and the preponderant influence which they exert over them, and in the fact that their officers and directors recognize an unusual measure of public responsibility.

No phase of recent American banking is more striking than the groping of our 25,000 independent banks toward some coherent organization and leadership. This is shown not merely in the consolidation of great city banks and the affiliation of banks and trust companies, but in the development of association and joint control through the clearing houses, and the absorption on the part of these institutions of new and far-reaching functions. The adoption of methods of mutual supervision through clearing house bank examinations which has been so much in evidence in western and middle western cities during recent years is one step in this direction. The more careful regulations governing the conduct of firms which are admitted to membership in the clearing house, and with regard to the non-member institutions which clear through members, about

which so much controversy has centered during recent years in New York, is another instance of the same tendency. Above all, the resort to clearing house loan certificates in times of unsettlement which became so surprisingly general throughout the country in 1907 is the best illustration of the way in which our banks are forced at times to act together under common leadership. It shows, too, how an ingenious people can improvise a needed institution if it does not already exist. The operations of the clearing house associations during the panic of 1907 were essentially akin to the ordinary functions of the Bank of England, the Reichsbank, and the Bank of France. With the banks as customers, these clearing house associations made loans on collateral, rediscounted notes, and made the reserves of all of the banks available for each other in practically the same way as do the great national banks of Europe. The operations were of an identical nature, but there were two essential differences in form and in measure of effectiveness. First, the arrangements had to be devised in the stress of an emergency, and only began to operate after the panic had become acute, and it was no longer possible to forestall the general collapse. Second, there was no general clearing house association for the country as a whole, and even though the banks of each locality were able by a belated expedient to pool their reserves and transform their commercial paper into available, liquid assets, there was no arrangement for a similar settlement of accounts as between different cities. Hence the struggle which was witnessed of each locality endeavoring to fortify itself at the expense of every other locality—a spectacle which could not have occurred in any European country and which we ought to make impossible of recurrence here.

Another respect in which the banking arrangements of other countries differ from those of our own lies in the greater mobility of their reserves. This is partly due to the absence of any requirement that a proportionate minimum of actual cash be maintained inviolate against all deposits,—a requirement which exists in our national banking law and has been copied to some extent in the banking laws of most of the states, but which has no counterpart, so far as I am aware, in the legislation of any other country in the world. With us it fixes an uncompromising limit to the expansion of loans and discounts and prevents the reserves of our banks from

really serving as reserves. From the instant that the required reserve has been touched, no matter how critical the need, if the law is strictly enforced, no further accommodation can be granted. There are no such restrictions in other important countries where most of the reserves are pooled in the central institution and where the usual practice in periods of unsettlement is to lend and discount freely to all who have legitimate requirements. Thus panics are suppressed elsewhere as gypsy moths or other pests are suppressed, while they are still in embryo. The requirement of an unusable cash reserve against deposits is peculiar to our system alone. One of the German bankers whom we interviewed last year, described the American reserve system very aptly by comparing it to the regulations with regard to cab-stands in the city of Berlin, where the law demands that there shall always be at least one vehicle at each of the appointed stands. Under this law, a man returning home in the course of a wet and windy night and finding a cab on the street corner may be unable to employ the cab because the law provides that there must always be a reserve of one cab at each of the appointed stands. So, no matter what the exigency, no matter how insistently a precarious situation in the financial world demands a liberal extension of accommodation on the part of the banks, our institutions, unlike those of any other banking system in the world, are prevented from responding to these demands by this uncompromising restriction of deposits to an untrespassable maximum proportioned to the cash reserves.

The reserves of the banks in European countries are more mobile than our own for another and more important reason. In England, or France, or Germany, or in any of the other important countries, the banks are accustomed to consider as equivalent to cash actually held in their own vaults, the balances held for them by their great central institutions. If because of the seasonal recurrence of increasing credit demands, or on account of temporary unsettlement of confidence, the reserves of the banks need to be strengthened, such increases can always be effected by the individual banks by transferring to the central institution some of their bills-receivable, or commercial paper, and receiving in exchange through the direct or indirect process of rediscount, an increased balance upon the books of the central institution. As these balances are regarded and treated as identical in every way with cash, the

reserves of European banks are widely flexible, and the banks are able at any time within reasonable limits, to transform their solvent assets into available reserve funds. At the same time the pooling of a large part of the reserves of the individual banks in the central institution makes it possible to supply without disturbance unusual demands for cash arising in any particular part of the country as well as at particular seasons of the year. The lack of any such flexible and easily mobilized reserve power in America forms one of the most conspicuous contrasts between American and European banking arrangements.

A third respect in which the drift of the world's banking is in a different direction from that of this country concerns the matter of note issue. The tendency of note issue regulations in every other country is manifestly toward concentration in its control. When the great act of Sir Robert Peel in 1844 established the English system of note issue upon the basis on which it stands to-day there were 279 banks in England issuing notes. The act provided for the gradual absorption of all of these issues by the Bank of England, and at the present time there remain less than thirty note issuing banks outside of the Bank of England, with a total issue amounting to less than £500,000, or only one per cent of the total issue. In Germany when the bank act of 1875 was adopted thirty-two other banks throughout the empire were issuing notes to the extent of 135,000,000 marks, but that act, like the English act of 1844, provided that as these banks forfeited their rights to circulation the Reichsbank should be allowed to absorb their note issuing privileges. To-day there remain in Germany only four note issuing banks aside from the Reichsbank with a total note issue averaging less than twelve per cent of the whole. In France the Bank of France has been the sole source of circulation for more than sixty years, or since its reorganization in 1848.

In quite recent years a number of other countries have brought their bank note issue system into line with those just mentioned. In Italy, beginning in 1893, the government entered upon a course of legislation tending toward the concentration of note issue in the Bank of Italy, and already of the six banks which at that time were issuing notes, only three remain—the Bank of Naples and the Bank of Sicily, with minor privileges, and the Bank of Italy, sponsor for

three-quarters of the total circulation of the country. When Japan, emerging from feudalism, reorganized her banking system early in the seventies, she adopted the American system of decentralized issue, but after an experience of only a few years she turned to Europe for her models and adopted a system of centralized issue patterned after that of the Bank of Belgium. In Sweden, one of the last countries to change, down to 1900 there were no less than twenty-seven separate enskildabanks endowed with the privilege of issuing notes, but by legislation of that year, a centralization of issue was arranged for, and since January 1, 1904, the Bank of Sweden alone has had the privilege. Most recently of all in Switzerland, where for generations notes have been issued by a system of cantonal banks, the Swiss National Bank, organized by the act of 1905, has taken over the authorized circulation of the eleven other institutions which up to that time had enjoyed the privilege of note issue. The fundamental reason for the drift of the world toward centralization in the control of note issue is not altogether clear, but the main advantage probably lies in the possibility of concentrating its control under a single body of men who are conscious of public ends and the opportunity which ensues for better adaptation of currency supply to currency demand, for stronger control over credit expansion and for wiser and more immediate relief in times of emergency and incipient distrust.

The importance of the question of note issue arrangements has been very much exaggerated by writers upon currency reform in this country. In the course of the last half century it has become the custom of banks throughout the world, and more particularly of banks in the Anglo-Saxon countries, to lend their credit in the form of deposit accounts rather than in the form of notes; on this account the matter of the issue privileges, which was formerly the principal feature in banking legislation and the main subject of discussion in banking literature, is ceasing to have the importance which it used to command. The thought of the world moves slowly, and it only recognizes essential changes in conditions reluctantly and long after they have occurred. The banking problem as it still presents itself to many financial writers is limited to the search for improvements in the regulation of note issues, but in reality this question has for decades only concerned a minor phase of credit organization.

This is not the occasion to present the details of the banking systems of other countries. I have only intended here to sketch in broadest outlines some of the features that are common to the banking systems of practically all of the other countries of the world—features which we in America lack, and which perhaps may have enabled other countries to meet the fluctuating exigencies of business more effectively than we have been able to do. I have not sketched the peculiar features of any single country; I have merely gathered together what is common to them all. I have no idea and no member of the commission has any idea that the detailed arrangements and regulations governing banking in any other country are applicable to the United States. I do believe, however, that some of these features which are common to all other banking systems should be carefully examined before we make any attempt at domestic reform, and, as I have endeavored to explain, the most distinctive characteristics of European banking, in my opinion, are the greater unity and coherence of their organization, the greater mobility of their reserves and the greater concentration of control in their note circulation.

The history of currency legislation in the United States during the last forty years has not presented a story to which any well-informed and intelligent American can point with pride. At the end of the Civil War we found ourselves encumbered with an inconvertible paper currency issued to defray the expenses of that great war, and for fourteen years thereafter this currency circulated at a discount while successive legislatures proposed varying plans for its retirement and for the resumption of specie payments, only to modify and repeal them. It was not in fact until 1879, or nearly a generation after the issue of the greenbacks, that the government fulfilled its obligation and undertook their redemption. From that date for another generation successive Congresses dealt with the problem of silver coinage with equally inapt vacillation, and it was not until the year 1900 that the world was finally assured that this country would continue to use as its monetary standard the metal which had been the undisputed standard of all the other leading nations for a quarter of a century. We are confronted to-day with the third great currency problem of the last fifty years. We are looking for the means of improving our banking system so that we

may avoid for the future the wide-ranging catastrophes with which American business has been periodically distressed, and through which the respect for this country abroad has been impaired. Having established our standard of value on the world's basis, we are now trying to devise a banking system more worthy of our position in the world and better adapted to further the uninterrupted development of our great resources.

Fortunately in this great task we are presented with a means of resolving the complexities of the problem such as has not existed with regard to any other problem in our history. We have a commission of distinguished membership which is devoting itself with deliberation to a scientific study of banking difficulties at home and banking experience in the rest of the world. The commission includes representatives of all sections of the country, from states as widely separated as Maine, Louisiana, Texas, Pennsylvania, Virginia, Colorado, and California. At its head is a masterful leader, clear thinking, unvisionary and thorough, whose one ambition is to crown a long career with a great constructive law. The outcome I am confident will show that the members of this commission, whether Republicans or Democrats, realize that the questions before them are vital to the development of the common country, and that the issues are of far too wide a scope to be treated from the viewpoint of sectional interests or partisan politics.

The problem before the National Monetary Commission is well suggested by its analogy with the problem of providing protection against certain kinds of physical catastrophes, such as fire. There are at least three ways to protect one's self and belongings against loss by fire. One may equip a house with fire-escapes and in case of a blaze make one's way out as best one can, saving one's self but leaving home and possessions to destruction. A better method is to equip one's house with fire extinguishers, so that if an incipient blaze occurs one has the means to combat the flames and to prevent the complete destruction of one's property. The best method, however, of protecting self and home is by fire-proofing the entire structure; then there remains no real need for anxiety, for only under conditions of extreme carelessness can any considerable damage be accomplished by fire.

In the financial structure of this country we have seldom pro-

vided any method of protection against possible disaster beyond the means of escape, and even these we have generally left to be improvised after a catastrophe was under way. Under the so-called Aldrich-Vreeland act of May 30, 1908, provision was made for equipping our financial edifice with something akin to extinguishers in the shape of currency associations and emergency currency to which the banks could run for relief in case of impending destruction. But these extinguishers are only of limited usefulness. They can only be employed after emergencies are under way, and the law only gave them a period of effectiveness of six years. The act of 1908 provided, however, that during these six years experts should be engaged to examine into the methods of panic-proofing employed in other countries in order that means may be devised by which our own financial system may be panic-proofed and panic risks for the future eliminated. This is the problem before the National Monetary Commission.

FINANCING OUR FOREIGN TRADE

By Frederick I. Kent,
Vice-President, Bankers Trust Company, New York.

The foreign trade of the United States has increased during the last forty years about 370 per cent. The combined exports and imports in 1870 were exceeded by the exports alone in 1880, and in 1909 the total foreign trade was almost double that of 1880 and amounted last year to $3,203,000,000. This increase in our foreign trade reflected not alone our own marvelous development, but as well the wonderful growth of trade throughout the world. The United States stands third among the countries of the world, its foreign trade being exceeded only by that of the United Kingdom of Great Britain, whose total in 1909 reached $4,881,000,000, and Germany with a total of $3,544,000,000; France was fourth with $1,995,000,000.

Before considering the methods under which our trade is financed, it would be well to have in mind the nature of our foreign trade, including in a general way the commodities imported and exported and the points from which they emanate and to which they go.

Imports each exceeding $100,000,000 in value:

Beverages, including coffee, tea and cocoa.
Silk and manufactures.
Hides, skins and leather.
Metals—copper, iron, tin and lead.

Under $100,000,000 and exceeding $75,000,000:

Sugar.
Various chemicals.
India rubber.
Wool and manufactures.

Under $75,000,000 and exceeding $50,000,000:

Manufactures of cloth and laces.
Fruits and nuts.
Wood and manufactures.

Under $50,000,000 and exceeding $20,000,000:

Wines and spirits.
Diamonds and precious stones.
Tobacco.
Furs.

These few commodities represented about seventy-seven per cent of our imports in the year 1909. Of the total imports $763,000,000 came from Europe, $277,000,000 from North America, $193,000,000 from South America, $190,000,000 from Asia, $32,000,000 from Oceanica, $17,000,000 from Africa. Aside from the imports from North America, practically all of these commodities were financed through Europe and a large proportion of this total through London. The detail of this financing was largely carried on under the instrument known as the commercial letter of credit. An explanation of the operation of the commercial letter of credit will, therefore, disclose the methods and conditions under which our imports are financed.

The commercial letter of credit is an authorization, say of an American bank to its London correspondent, to honor drafts for its account drawn at various tenors by foreign shippers or others against shipments of merchandise to this country. These credits are of two kinds, documentary and clean. Under the documentary credit the London bank is authorized to accept drafts for the account of the American bank only when the bill of exchange is accompanied by certain documents described in the letter of credit. These documents may be the bills of lading for the goods, consular invoices, insurance certificates and possibly other papers. Probably a large proportion of such credits requires that drafts be drawn at sixty or ninety days' sight. So many elements of danger are involved in financing commodities under commercial letters of credit, even where the control of the goods is given to the bank issuing the credit or its agents, that the financial standing of those asking for credits must be the first consideration in their issuance. Dishonesty on the part of the shipper, resulting in a drawing under the credit against forged documents or against shipments of inferior merchandise, is always possible, and the financial responsibility of the buyer of the credit is all that stands between the banker issuing the credit and a loss in such cases.

In order to obtain a clear understanding of the working of a

commercial letter of credit, we will take a concrete example and follow its every transaction. An importer of coffee (A) in New York purchases a certain number of bags of coffee from an exporter (B) in Brazil. A agrees to furnish B with a commercial letter of credit. B is not in position, we will say, to await the arrival of the coffee in New York and the return of a remittance before receiving his pay. A on the other hand is unable to remit B for the coffee before its receipt and sale to his customers. A goes to his banker in New York and requests him to authorize B to draw upon the New York banker's London correspondent at ninety days' sight with bills of lading for coffee to the amount of the purchase attached to the draft, consular invoice and insurance certificate, if B is to furnish the insurance. If A's banker is willing to extend the credit he writes a letter (or uses a printed form), requesting his London banker to accept B's drafts upon presentation under the conditions already mentioned and others of minor importance. This letter is issued in duplicate, one copy going to the London banker, the other being delivered to A. A then mails the copy received by him to B. B thereupon arranges to ship the coffee, obtains the bill of lading, invoice, etc., and takes them with the copy of the credit to his banker in Brazil. A draft is then drawn on the London bank under the terms of the credit at ninety days' sight and is discounted by the Brazilian banker, the proceeds being placed to the credit of B's account or given to him in the form of a check or cash. The Brazilian banker then forwards the draft and documents, except such documents as the instructions may require to be forwarded direct to New York, to his London banker. He may secure discount of the bill at once by cable or await its arrival in London before doing so, or he may request his London banker to have the bill accepted and hold it for maturity. If the bill is discounted the Brazilian banker may draw against it immediately and thus put himself in funds to purchase other coffee bills. Upon receipt of the bill by the London correspondent it is presented to the London banker on whom it is drawn for acceptance. The acceptor bank examines the documents and if they are drawn according to the terms of the credit accepts the draft and returns it to the correspondent of the Brazilian bank, retaining the documents, which it then forwards to the New York bank which opened the credit. In accepting the draft the London bank has in effect agreed to pay it at the end of ninety days,

or, figuring grace, ninety-three days. Upon maturity payment is made and the amount is charged to the account of the issuing New York bank. Upon receipt of the documents the New York bank delivers them to its customer under a trust receipt or against collateral, and the latter is then in position to obtain the goods. Ten days before the bill of exchange is due in London the New York bank collects the amount from A, together with the commission agreed upon when the credit was opened, and remits the amount to its London banker to meet the draft. On all such transactions the London banker, while not himself advancing any money, is extending a credit for which he charges the New York bank a commission. The result is that we are paying tribute to European bankers amounting to an immense sum annually for the purpose of financing our imports.

The fact that London exchange is more marketable generally throughout the world than New York exchange is one of the principal reasons why it is necessary for us to issue credits upon London instead of upon New York. Another reason lies in the doubtful authority of American banks to accept time drafts upon themselves.

If our foreign trade should become extended enough to make New York exchange thoroughly marketable in all parts of the world, banking conditions in this country would have to be changed somewhat before we could save the cost of the commissions for acceptance, which we now pay to foreign bankers. We must expect, therefore, to continue to pay Europe commissions for acceptance, as well as freight and insurance in carrying on our foreign trade until our laws are changed. These three items undoubtedly go a long way toward offsetting our favorable trade balance in merchandise.

Our imports are distributed generally throughout the United States. The importers, however, are mostly situated at the ports of entry. A very large proportion of them obtain their credits through New York institutions, although some of them deal direct with foreign bankers. Imports may be stored in bonded warehouses without the payment of duty until such time as the importer desires to obtain the goods for delivery to his customers, provided they are not left to exceed three years. The interest saved on the amount of duty payments thus delayed is quite an item and enables our importers to ship to this country many classes of goods at the low rates that orders in bulk make possible, which they could only

otherwise import in small quantities and at high prices. While practically all classes of our imports are distributed generally to our people, yet our exports are largely localized. The center of our manufacturing industries lies not far from the center of the State of Ohio. The center of our cotton area is in Mississippi, of our corn area in the western central part of Illinois, of our wheat in Iowa and of our total farms in central Missouri. Our exports are made up of products from these various areas, the centers of which have been continually moving westward and will probably continue to do so for some years yet. Our principal export is cotton, which in recent years has averaged about $650,000,000 annually. Other exports are copper, iron and steel, $250,000,000; meats and dairy products, $150,000,000 (a sum which has been decreasing annually for several years); corn, wheat and flour, $125,000,000; oil, $103,000,000, and other commodities totaling under $100,000,000 but exceeding $25,000,000 in about the following order: Lumber, leather (manufactured and unmanufactured), tobacco, coal and coke, cotton manufactures and agricultural implements, all together amounting to seventy-seven per cent of our total exports.

Probably a smaller proportion of our exports is financed by means of commercial letters of credit than of our imports. Different commodities are handled in accordance with special customs which have grown up around them, due partly to trade conditions and partly to the nature of the products. Sellers of grain usually draw at sixty days' sight upon the foreign buyer instead of under a bank credit. These bills, under the customs prevailing in most foreign countries, may be rebated by the foreign buyer whenever he desires to obtain the goods at the "bank rate" or one per cent under the bank rate, or such other rate as custom in the country on which the drafts are drawn requires. Such drafts, with bills of lading and such other documents as are necessary, are purchased by American banks and are forwarded by them to their European correspondents. The American banker is obliged to advance the money on such paper, unless he draws his own time bills against them, until such time as they are rebated. In the case of grain bills the average time rebated is probably around fifty-six days, which places the American bank in possession of demand foreign exchange, against which it can draw in order to reimburse itself with the loss of a very few days' interest.

Flour bills, which are financed in the same manner as grain bills, usually run nearly to maturity before they are rebated, although the condition of the discount market sometimes influences the purchaser, and causes him to take the bills up more promptly. Many foreign shipments are made under three day sight bills, which uses the money of the American banks making the advance from four to seven days or more, depending upon whether the laws of the country on which the bills are drawn allow grace or not and whether the bills are purchased with intervening days before the sailing of steamers. Other classes of bills are drawn at sight. This includes a portion of our lumber shipments and miscellaneous articles. Where shipments are made on sailing vessels, drafts are frequently drawn at four or six months' sight, and many other transactions go through against cable payments.

As nearly forty per cent of our exports consist of cotton, the method under which it is financed is worthy of special consideration. Cotton bills are ordinarily of two kinds: documentary payment bills and bills drawn upon bankers. Documentary payment bills, which are drawn upon cotton merchants or spinners at sixty or ninety days sight or other tenors, are handled in the same manner as flour bills. The cotton merchant accepts the draft upon presentation and rebates it when the goods arrive, or when he desires to obtain the cotton. A small percentage of cotton is handled in this way. Most of the commodity is financed by means of credits opened by the foreign buyer through his banker. Various abuses have developed under this system, which have caused losses running into millions of dollars to all of the various parties engaged in carrying the transactions to their close. These losses have only been possible because of the turning over of credits by the foreign buyers to irresponsible concerns in America in their endeavor to obtain cotton at lower prices than their competitors. A foreign buyer makes arrangements with certain American concerns to cable him offers of cotton. The American firms whose offers are accepted receive cablegrams from the buyer advising them of the acceptance of their offers and giving them the names of the foreign bankers on whom the drafts in payment of the cotton are to be drawn. The American sellers thereupon ship the cotton to the buyer under bills of lading drawn to the shipper's order and endorsed in blank. The bills of lading are then attached to drafts drawn upon the bankers designated by the buyer

at the given tenor, which is usually sixty or ninety days. This exchange is then sold in the market to the highest bidder or it is forwarded to New York to be sold in the same manner upon arrival. The American exchange buyers have no means whatever of designating whose bills shall be upon the market, as the sellers are all agents of the European buyers. The American exchange houses in their need for exchange to meet the demands of their importers have accepted the bills offered in the market, each exchange man endeavoring to keep his "water line" on weak names as low as possible. If the European buyers only dealt with first-class houses only first-class bills would be offered, but when they deal with second- or third-rate houses, or houses with no standing whatever, such bills drawn upon prime European banks come upon the market.

The American exchange buyers having the cotton as collateral while the drafts are on the water, and then having the acceptance of a prime European bank for the sixty or ninety days following before maturity of the draft, have accepted these risks, although unwillingly, for want of better bills. They endeavor to protect themselves as far as possible by trying to buy bills only of those in whose honesty they have reason to believe, whether they have any capital back of them or not. If the cotton were actually shipped under a bona fide order, any fluctuation in the value of the cotton which they accepted as collateral, although taken entirely without margin, would probably cause them neither loss nor friction. They have run the risk, however, of having forged documents forced upon them which did not represent goods, or exchange that was drawn without authority. Lines which exchange buyers are willing to take from each cotton shipper before acceptance, and the name of a prime European banker is added to the paper, have to be based upon this consideration.

In the spring of 1910, forged and fraudulent bills of lading for cotton were attached to drafts that were sold in the foreign exchange market, which resulted in serious losses to both foreign and domestic buyers and bankers. The foreign bankers thereupon appointed a committee to investigate the matter and to recommend some means under which bankers accepting drafts for cotton could be protected. This committee instead of coming to America met in England, which being so far from the seat of the trouble made it impossible for it to get at all of the facts. The committee arrived at a decision

not at all in accordance with the requirements nor the possibilities of the case. A resolution was then passed demanding that American exchange buyers guarantee the genuineness of the signature on all bills of lading and the further fact that the goods had actually been delivered to the railroads. In the meantime American bankers and railroad men were holding meetings for the purpose of changing the methods under which bills of lading were issued in such manner as to make fraud more difficult and the risk undertaken by foreign bankers in accepting drafts with cotton bills of lading attached a more reasonable one. A system of validation was agreed upon under which "through order notify" bills of lading are to have validation certificates attached, which proclaim the authority and guarantee the genuineness of the signature of the railroad agent. The validation certificates are to be charged to the agents and audited in the same manner as is done with passenger tickets. They are to be numbered and printed upon a specially protected watermark paper, and are to be attached to the bills of lading in such manner as to make it practically impossible to remove them without detection. These validation certificates will serve a number of purposes and among others will make it possible for those who wish to advance money upon bills of lading to determine with some certainty whether the bills are genuine.

The old form of the cotton bill of lading which has been signed by freight agents or their assistants or others has been an instrument not possible to authenticate. This was particularly dangerous, due to the manner in which bills of lading were issued. They were formerly given out to the shippers, who filled them in and returned them to the railroad agent, who in turn often signed them without having any knowledge as to whether the goods called for by the bill of lading were in his possession or not. Under the new system, no validated bills of lading are to be given up until the goods are actually in possession of the railroads. This system went into effect September 1, 1910, and it is confidently hoped that it will give sufficient added safety to the bills of lading of American railroads to satisfy the foreign bankers.

The very act of guaranteeing such bills is recognized by foreign bankers as being wrong in principle, and while they are requesting that American exchange buyers guarantee bills of lading for exports yet on the other hand they particularly call attention to the fact that

no bills of lading which pass through their hands for imports to the United States are guaranteed by them in any way, shape or manner. This glaring inconsistency and abrogation of a principle even while it is being stated, can only be attributed to a lack of proper consideration of the subject. There is no doubt, however, but that the whole matter will be adjusted in a manner which will be fair to all concerned. It was quite natural that the tremendous losses incurred through the recent frauds should have at first caused extreme action to have been taken, but it is confidently hoped that our exports of cotton will be handled this coming season without friction or delay. This being the case, the time bills upon foreign bankers will be discounted abroad and the proceeds used to pay for our imports as usual.

The money to finance both our imports and exports is largely furnished by foreign bankers or discount companies. This is of great value to the old countries where capital has accumulated that would otherwise lie idle, and it is of great value to the United States as it enables us to use our own rapidly multiplying capital to develop our country and our industries. In the case of both imports and exports, while the actual capital is largely furnished abroad, our own banking institutions are primarily extending the credits, either through an authorization to foreign bankers to charge drafts drawn under commercial letters of credit to their accounts at maturity in the case of imports, or through the endorsement of bills for exports. Our bankers consequently first feel the necessity for gold shipments, as their inability to meet their obligations with exchange on the one hand or to find a market for their exchange on the other calls for the exportation or importation of gold.

Our imports average about the same amount monthly throughout the year, except during the time of a financial crisis or a change in the tariff. We have then had sudden fluctuations in the imports, which have been very marked. For instance, in 1907 our imports fell off after November from $110,000,000 a month to $92,000,000 in December and $84,000,000 in January and February of 1908, and again in the year 1909 great quantities of merchandise were brought in anticipating expected changes in the tariff, which were being considered that year.

The exports, on the other hand, do not go out regularly, but are much larger in the fall and winter months than during the sum-

mer months. The reason for this lies in the fact that a large proportion of our exports is made up of various crops which ripen in the summer and mature in the fall. A larger amount of exchange, therefore, is made from our merchandise exports after the summer months are over than is required to pay for our imports. Due to various causes, our exports are gradually changing their character and manufactured articles are making up a larger percentage of the total. If it were not for our tremendous exports of cotton, which will undoubtedly continue for the time being in spite of the more or less spasmodic attempts of various foreign countries to grow their own supplies on colonial lands, our exports would soon become as regular as our imports are: as the increase in proportion of manufactured products, which can be produced and shipped equally well at all seasons of the year, has a tendency to equalize monthly shipments. This will have its effect upon foreign exchange rates and cause them to rule more uniformly throughout the year, except at such times as they may be influenced through extraordinary occurrences, such as extreme buying or selling of stocks by foreigners, panics, unusual differences in the value of money in the different countries, etc.

In summary, it may be said that our foreign trade is actually financed largely in London and partly in Paris, Berlin and other European financial centers, but at the risk and upon the credit of American banking institutions. We pay Europe interest and commissions for the use of its money; and, while we have been content to do so in the past, the future will find a shifting of the load on to our own shoulders to a considerable extent. This will come about more and more as our floating capital finds less demand for use in our industries and in the development of our resources. Such a condition will, of course, be greatly retarded by our banking laws, but when the necessity becomes sufficiently great they will be changed to meet the emergency. Then the laws of supply and demand will be allowed free action and will be unhampered by expensive and unnecessary restrictions. In the meantime, while our influence will be great, our actual international, financial force will continue to be comparatively small; but the day will surely come when we shall take our place among the nations of the earth as a real commercial power.

THE EXTENSION OF AMERICAN BANKING IN FOREIGN COUNTRIES

By Samuel McRoberts,
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Until recent times foreign affairs have commanded comparatively little public interest in the United States, but with the broader political position of the nation resulting from the Spanish war and the establishment of a more definite and continuous foreign policy, the interest in our international relations has become much intensified. Along with this quickened interest has come a more general study of our commerce abroad. This study is partially inspired by the general interest in our foreign political relations, but more potently stimulated by the realization that we are reaching the point where, as a nation, we have need at home for those materials and food products which have in the past constituted the bulk of our export trade. Although we have had an increased production during the last three years, our export of unmanufactured food products has declined forty-two per cent, and the export of food products partially manufactured has diminished twenty-two per cent. This decrease has been so marked as to strengthen the conviction that the contribution of foodstuffs that the United States is able to make to the outside world is steadily diminishing, both in actual value and in the percentage of our exports which this class of goods represents. Practically all our public lands have passed into private and productive ownership, and the growing need for our agricultural products, at home, has been such that the competition in domestic markets has raised the price until the exporter is unable to meet the competition of foreign producers. Wheat has, for a large part of the time during the last two years, been steadily above parity for the Liverpool market. American beef, at current prices, can compete in London with the products of Australia and Argentina only in a limited section of the trade. Not having tillable public lands in reserve, we can increase our production only by more intensive processes and on a higher basis of cost. As a consequence, we are

necessarily turning to manufactured products to maintain our balance of trade with other nations.

In the past the people of the United States have concentrated their minds upon domestic problems; enormous resources had to be developed and a new civilization established. By logical sequence it follows that the American is not a cosmopolitan; that he is indifferently qualified to approach business problems with a clear understanding of the world's needs. The growing necessity for a trade abroad in manufactured articles is forcing the American into a comparatively new field, for which he is admirably equipped in all save experience and the institutions constituting the machinery of such commerce. Raw materials and food products—necessities abroad—have easily been marketed, requiring no such equipment or skill as the merchandising of manufactured goods when in competition with foreign tradesmen who long have occupied the field. American merchants and, to some extent, the American public, are beginning to recognize this situation. From an attitude of complaisant superiority they are becoming aroused to an intelligent examination of foreign markets, and to a comprehension of the conditions that must be complied with, and the equipment necessary to successful operation. The essentials for this foreign merchandising, obtainable through individual application, can be readily acquired; the particular customs of a market, the characteristics of the people, and the class and quality of the goods desired. But that part of the equipment for foreign commerce, which provides transportation and financial exchange, is not to be procured by individual efforts. It can be obtained only through the organization of certain specific forces of civilization, such as units of capital, highly specialized knowledge and the authority and co-operation of governments. It is the acquiring of this part of the equipment for foreign commerce that presents the more serious problem.

It has long been a subject for comment that Americans are obviously content to do their international business through the banks of their foreign competitors. That they have done so at any time, contentedly or not, is inconsistent with American characteristics. That they continue to do so, after having amassed an enormous banking capital and a foreign trade of more than $2,500,000,000, calls for some explanation. Whatever the past causes for such inaction may have been, it is no longer to be explained on

the ground of indifference. The necessity for the establishing of American banks abroad, in the aid of commerce, has been repeatedly and persistently pointed out by American travelers, the consular service, the State Department of our Government and the public press; and of late it has been so insisted upon as to augur an oblique criticism of the initiative and intelligence of American bankers.

American banks in foreign markets would be powerful aids to the upbuilding of our commerce; manifestly and for the subjoined reasons are they indispensable:

First. They would furnish a direct financial exchange.

Second. They would provide a safe and efficient means of obtaining credit-information, independent as to foreign merchants and impartial as to American exporters.

Third. They would correctly present to foreign customers the standing of our own export houses.

Fourth. They would furnish capital or credit at the foreign market.

Fifth. They would bring American financial interests in touch with foreign enterprises, which, if exploited, would create business for the American exporter.

A direct financial exchange is important because it puts the least burden on the business and is most readily understood and relied upon by the merchant. The difficulty in obtaining a direct exchange with another country comes not only from the dearth of American banks abroad, but from the legal restrictions that obtain as to domestic banks. One of the fundamental principles of European banking practices is that a bank is permitted to sell its good name in lieu of money advanced or a credit placed at the disposal of a borrower. An English manufacturer purchasing materials abroad does so through personal representatives or local firms appointed as agents. When a purchase is made, knowing that the goods must be paid for before shipment, he receives from his banker, commensurate with his financial standing, a credit, to the effect that the bank will *accept* (guarantee payment) sixty- or ninety-day drafts drawn by the foreign agent with shipping documents attached. These shipping documents are so made as to give the holder of the full sets of bills of lading an absolute control of the goods until they reach their destination. The agent, armed with this draft and the shipping documents, is enabled immediately to place himself in funds

by the negotiation of this instrument; and the purchaser of the drafts is absolutely protected until the bill of exchange is accepted by the English banker, to whom, in consideration of his acceptance, the document must be surrendered. This practice enables the European merchant to finance his purchases in foreign countries at a minimum cost; and it has contributed enormously to the development of foreign trade. This simple and inexpensive means of bridging the seas could be secured to the American merchant in either of two ways; by the establishing of domestic banks with branches abroad, or through the domestic banker's acceptance of the merchants' drafts. If but American banks had branches abroad, the merchant's deposit in the parent bank could readily be made available at any of its foreign branches; or if an American bank, well known abroad, could add its credit to that of the merchant's by guaranteeing his transactions in accordance with established business usage, he could deal direct with all the ports of the world.

But the American banks have no branches abroad, and they are, moreover, restricted by law from making time acceptances or otherwise guaranteeing commercial paper; and in consequence the American merchant is forced to employ the services of European banks to finance his transactions. This facility, of course, must needs be well paid for, as the good name of the European banker is not sold cheaply. As a result, the American importer must establish his credit with strangers or suffer the inconvenience, delay and expense of an indirect exchange. A like disadvantage confronts the exporter, for the identical conditions that forced payment in European drafts made those same European drafts the most available exchange for the purpose of collection. Thus the European banker takes toll of our commerce, be it export or import. In addition to the immediate handicap, resulting from indirect exchange, the American suffers collateral disadvantages. For instance, the quotations of the markets of the world are expressed in the nomenclature of Europe—marks, francs or pounds sterling—seldom if ever in American dollars; therefore the American, in naming his price, unavoidably directs the mind of his customer to the European competitor. Furthermore, American prestige suffers seriously from these indirect financial transactions. America conducting her foreign trade through the banks of her neighbors is in about as commanding a position as is a

bank in a large city that is not a member of the Clearing House Association.

Apart from the question of exchange, the American merchant, in extending his trade, suffers from the lack of intimate contact and confidential relations with the business life of other countries, which can best be supplied by resident American bankers. Under the present state of affairs, if he would inform himself as to particular trade conditions, as to the standing of a customer or make any of the confidential inquiries that are incident to business, he must seek some other firm that is engaged in the same territory in which he is operating, or a banker having much closer affiliations with his competitors in Europe. There has been an effort made to supply this deficiency through the mercantile agencies, but the people of South America and the Orient do not take kindly to the interrogation of such agents; and the information, which otherwise would be readily obtainable by a banking institution, is often withheld and the inquiry resented. American banks abroad would be dependent for their prosperity very largely upon the extent of American commerce in their territory, and, by reason of self-interest, would be the most potent promoters of American enterprise, just as experience has proven the European international bank to be a vitalizing element in the all-nations trade of Europe. Excepting the United States, every important country that is engaged in the exporting of manufactured products, has furnished the facilities under notice for trade through the extension of its banking system to foreign territory. The customs of banking and the laws of the various European commonwealths are not unfavorable to the upbuilding of international banks, consequently the European banking house may set up its branches to the ends of the earth. English banks are as universal as commerce, while those of Germany, France and Italy are co-extensive with German, French and Italian trade. For illustration, take a certain English international bank as being typical under the British system. This is a bank incident to the English interests in South America. Its home office is in London and, as an institution, it is a citizen of England and under the protection of that government's foreign policy. It has branches in Valparaiso, Santiago, Iquique, Antofogasta, Copiapó, Coquimbo, La Serena, Chillan, Concepcion, Punta Arenas and Ovalle, Chili; Buenos Aires, Mendoza, Bahia Blanca and Rio Gallegas in the Argentine Republic;

Montevideo, Uruguay and Oruro, Bolivia, and additionally some forty-five agencies in other parts of South America. The ease, facility and safety for financial transactions, afforded to the Englishman and his interests in that part of the world covered by this institution, can be appreciated at a glance. The banking systems under which these banks are operated make it possible for them to utilize the credit and funds of the entire institution where and as needed, and, by means of the power of acceptances, to furnish the most stable and least expensive way for the transference of credits.

Unfortunately, no such freedom has been granted the banking capital of America. The United States has only one international bank, operating chiefly in the Far East. This unique position of a nation attempting to build a foreign commerce without the equipment of foreign banks is due to the restrictions of the American banking laws,—restrictions that in effect prohibit the setting up of such institutions. The National Bank Act was enacted at a time when little thought was given to foreign commerce. It was drawn solely with an eye on the internal needs; and a study of its text leads one to the conclusion that its author not only failed to make any provision for foreign banking, but, unwittingly, prohibited it by the terms of the act.

Under existing conditions it is possible to establish a bank in the United States in one of three ways: under the National Bank Act, as a national bank; under state law as a state bank, or by means of a co-partnership as a private bank.

Section 5190 of the United States Revised Statutes—part of the National Bank Act—sets forth the following edict:

> The usual business of each national banking association shall be transacted at the office or banking house located in the place specified in its organization certificate.

This section has been interpreted by every Comptroller of the Currency as prohibiting a national bank from establishing branches. The only exception to this prohibition has come by the conversion of state banks into national institutions under the authority of section 5155 of the Act, which declares:

> It shall be lawful for any bank or banking organization organized under State laws and having branches, the capital being joint and assigned to and

used by the mother bank and branches in definite proportion, to become a national banking association in conformity with existing laws, and to maintain in operation its branches, or such one or more of them as it may elect to retain, the amount of the circulation redeemable at the mother bank and each branch to be regulated by the amount of capital assigned to and used by each.

Under this section, only, the following named banks have been converted from state into national banks, retaining their branches under the provision of this section:

First National Bank, Milton, Ore.; branch located at Freewater, Ore.; converted July 23, 1908.—Bank of California (National Association), San Francisco, Cal.; branches at Virginia City, Nev., Portland, Ore., Seattle and Tacoma, Wash.; converted February 5, 1910.—Pascagoula National Bank, Moss Point, Miss.; branch at Scranton, Miss.; converted March 14, 1907.—First National Bank, Pontotoc, Miss.; a branch at Ecru in same state; converted February 21, 1908.

State banks, under the laws of but few states, are allowed to have branches outside of their immediate states and possibly abroad; but, if it were permissible to convert them into national banks, their branches would have to be designated before such conversion could be effected, thus making the organization inflexible as to its subsequent growth, either as to the number of branches or the amount of capital available for their separate use. It is true of the greater majority of the states that a bank, organized under state law, is restricted to one place of business, or, at least, to branches in the city specified by its charter as the place where its business is to be conducted. Mostly all of the states prohibit any foreign corporation, other than a national bank, from receiving deposits, discounting notes, or carrying on the usual transactions of banking within the borders of the state. The International Banking Corporation, chartered under a special act of the legislature of the State of Connecticut, has an organization with branches in England, China, the Philippine Islands and Panama, with its principal executive office in New York. But, withal, it can do no banking business in New York, and, perforce, is obliged to carry on its transactions in this country through an agency, on exactly the same basis as banks of foreign countries, a hindrance technically valid under the law, but, in equity, a poor recognition of the patriotic spirit and intelligent enterprise that prompted the founding of that institution.

Private or co-partnership banks are necessarily too restricted as to capital and resources and too unstable in their organization to command the credit and prestige necessary to foreign operation. Foreign corporations are excluded from the banking field here and in many of the foreign countries as well.

From the foregoing it is plainly evident that, under the prevailing status of the law, it is impossible to establish a bank with American citizenship that could conduct a banking business at any important point in the United States and, cotemporaneously, do a primary business abroad.

If there is to be a normal growth in the foreign commerce of the United States there must be an extension of our banking system, adequate to meet the conditions imposed upon the American merchant in his competition with the rest of the world. Obviously the first step toward securing such an extension would be to expand the scope of our banking laws, so as to give some legal basis for the international business. This might be accomplished by permitting the establishment of a new class of banks,—these banks to be under the authority and supervision of the Federal Government to the same extent as are now the national banks,—giving them all the powers vested in national banks, with the added privilege of establishing branches abroad, together with the liberty of making time acceptances of foreign drafts or other forms of commercial exchange originating abroad. Due caution could be observed by putting a logical limitation upon the power of such banks to lend their credit; moreover, by restricting the amount of outstanding guarantees to a definite proportion of their resources,—just as custom and the settled opinion as to sound banking now limit such operations on the part of European banks. The same result could well be achieved by extending these privileges—subject to regulation—to all national banks of sufficient capital, upon the approval of the Secretary of the Treasury and the Comptroller of the Currency. Either course would open the way for the international bank, with its headquarters at one of the centers of trade in this country and its branches covering a definite field of commerce abroad and with strength of capital that would give prestige and stability to its most inferior branches; or, to the same end, invest a national bank with the power to establish isolated branches where the needs of its patrons would make profitable such extensions. Thus situated, such banks would be enti-

tled to the full protection of the Federal Government in the proper exercise of their functions abroad; but, if subject to the supervision and regulation of federal officers, they would be powerless to embarass our government in its foreign relations. And no good reason presents itself why such banks could not be given efficient federal supervision. Examinations of foreign branches, co-ordinately with the parent bank, could be made by consuls or other resident government agents, appointed as deputy examiners for such a purpose. The four national banks, previously mentioned, have been regularly examined since their conversion from state banks, and, too, without administrative difficulties. Substantial precedents have already been created for the federal supervision of banks in a non-contiguous territory. There are four national banks in Hawaii, one in Porto Rico and two in Alaska. These banks are regularly examined and reported upon by deputy examiners resident at the several localities mentioned.

In brief, this extension could be brought about by amendments to the National Bank Act that would affect neither the present status of our domestic banks, nor would it incur the dangers and disadvantages that have been so unremittingly urged by the opponents of a revised banking system. Such a modification of our banking laws would disturb no vested interests and would confer no special privilege. Instead, it would open the foreign field equally to all sections of the country and secure to our foreign trade a normal development along the lines of the least resistance. This country, to-day, is employing a banking capital of $3,700,000,000, represented by the capital and surplus of its banking institutions; and when we compare this with the £84,000,000 of English banking capital, it can hardly be questioned that we are fortified abundantly to finance our own foreign commerce, and that the opportunity for so doing would straightway be turned to profitable account. Such a move would be timely from the standpoint of our present necessities, and would be a most important and logical step toward enabling the United States eventually to become a creditor nation.

ENGLISH METHODS OF LENDING AS CONTRASTED WITH AMERICAN

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Dissimilarities between English and American methods of lending are extraordinary in significance rather than in number. The principal points of contrasts may be attributed in the first instance to differences in geographical or physical conditions. The restricted area of England has made it peculiarly dependent upon other countries for raw materials and for markets for its manufactures. It has meant for England the concentration of a large part of its energies on the development of its foreign trade. The vast extent of the United States, on the other hand, has placed us under no similar necessity as to markets and materials. Great natural resources have enabled us to work with a wide margin of profit. England in its foreign trade has been compelled to work with a much narrower margin. Differences in margins of profit mean differences in necessity as to measures of economy, and herein we find the true basis of the more important elements of variance as respects English and American banking practice.

The effect of money rates on the profits arising from the development of natural resources, in mining, in the raising of grain and cotton is relatively small. On the contrary it is an item of prime importance in manufacturing industries, particularly in a country situated as is England. Our shipper receives payment for his raw cotton through the sale of time bills of exchange drawn on London or Liverpool as the case may be. The amount of dollars which he will receive for a given amount of sixty days' sight sterling bills depends directly on the rate at which these bills can be discounted in the London market, a high rate acting as a deduction from the price at which the sale and purchase of the cotton were arranged and a low rate having the opposite effect. The shipper, in other words, wants to be able to discount his bills at a low rate. If he can do this it means, other things being equal, a slightly higher price for his cotton. Conversely, it means that he can afford to take a slightly

lower price to the ultimate advantage of the English manufacturer of cotton goods. Whether, therefore, the discount rate is three per cent or five per cent is of material consequence to such manufacturer, adding to or lessening his cost of production and going far toward determining his ability to compete in foreign markets.

Likewise the probability of no extraordinary fluctuations in discount rates is of value in that it makes possible forward contracts for purchases of materials upon a favorable basis. A seller who can be reasonably sure that he will be able to discount his bills three or four months later at three per cent or four per cent or even five per cent will naturally be willing to take a less price for his goods than if there was a possibility of much higher rates prevailing at the time of the fulfilment of the contract.

The enormous responsibility which falls upon the English banking system to keep down money rates and to prevent wide fluctuations finds no counterpart in the United States. It is perhaps due to the fact that in England the function of the banks in lessening the cost of materials entering into manufactures and of imported food supplies is a matter of more or less general recognition, and banks are left comparatively free of legal restrictions which might tend to lessen their ability to meet the exigencies of the situation; whereas our comparative self-sufficiency in the matter of food supplies and raw materials has had the effect of minimizing popular interest in the workings of our banking laws and making difficult reforms which would inure to the public good. It is, at any rate, this difference in responsibility which accounts in a considerable degree to differences in methods of lending.

The most striking peculiarity of English banking practice, when brought into contrast with our own, is the use in the London money market of time bills of exchange as a basis for short loans, for a day or for a week. An explanation may be found in the fact that the extension of British foreign trade has carried with it the creation of a great amount of time bills of exchange, whereas the development of a new country of large area, such as the United States, occasioned the issue of a large amount of stocks and bonds of railroads and other industries, so that the loans of our American banks and English banks are naturally based upon quite different classes of securities. This explanation, however, is not sufficient. It does not take account of the fact that as a basis for loans, according to Eng-

lish practice, bills of exchange are made to rank side by side with British consols and other government guaranteed securities. It affords no reason why bills of exchange are made in the estimation of the English banker to rank above, so far as their utility as a basis for short loans is concerned, English railroad, industrial and municipal bonds and stocks which are not only sound in themselves but whose total is amply sufficient. The real explanation goes back to the difference in necessity of maintaining low and stable money rates. In involves, moreover, a further, though closely related distinction, between English and American banking objectives. This distinction is that England's prestige in the trade of the world is bound up in the preservation of London's position as the international banking center, while in a country as large as the United States, banking capital is necessarily spread over a wide area, a situation which militates against its concentration in New York and relieves us of any immediate ambitions to contest London's supremacy.

As differentiated from stocks and bonds, bills of exchange possess singular qualities with reference to their desirability as collateral to loans. They represent in large measure actual goods in transit. They are evidences of specific trade transactions. Within a short period they "will turn themselves into money." They therefore contain within themselves essential elements of security. Furthermore, the purpose which under ordinary circumstances is served by a loan on bills of exchange is one of high economic interest. In the London money market bills are dealt in by brokers who make their profits by financing their purchases by means of a loan and later selling the bills on a discount basis lower than that on which they were bought. In consequence, the lowering of the rate for short loans directly influences the market discount rate, and to that extent tends to lessen the cost of importing materials from abroad, thereby acting as a stimulus to trade and industry.

Apart from these considerations, there is a scarcely less important reason for the position occupied by bills of exchange in relation to short loans under the English banking system. It is that loans based upon them can, to a far greater extent than advances secured by stocks and bonds, be called with a minimum of market disturbance. Bills of exchange in the very nature of things are not suited to general investment purposes. They are not a form of

security which can be readily handled by private investors. Their early maturity and low yield make them undesirable. The margin of profit in buying them is also too small to warrant speculation in them in the ordinary sense of the word.

The absence of public interest and speculative positions in the securities, bills of exchange, upon which a part of his loans are based relieves the English banker to this extent of the anxiety attached to lending upon stocks and bonds. He is left with a comparatively free hand. Almost his sole consideration needs be his own position. His sense of security is twofold. In the first place any considerable calling of day-to-day loans is fraught with materially less risk to the general situation than if they were secured by stocks and bonds. Such a process does not involve the possibility of provoking realizing sales of securities by speculators who may either be frightened at the withdrawal of accommodations or who see in it an opportunity to make a profit on the short side of the market. It does not involve the public at large and lessens the danger of a rapid spread of alarm and the precipitation of a panic.

Another element of safety to English banks in the practice of lending upon bills of exchange is that the calling of such loans does not absolutely necessitate the borrower securing fresh money in London. When a joint-stock bank requires a bill broker to reduce his loans the latter first turns to some other joint-stock bank, or if he cannot make suitable arrangements there he can always fall back upon the discount facilities of the Bank of England. Even this resort, however, is not final in anything like an emergency, and for the following reason: Sterling bills of exchange are a favorite form of investment among continental banks and their transference from the loan departments of London banks to the discount portfolios of, for example, Paris banks, is neither unusual nor difficult. Almost immediately there is such a contraction in London money market supplies as to raise discount rates above the levels prevailing in European centers, and funds begin to move to London from these centers for investment in bills. Many of the great continental banks have London agencies, so that the process of shifting loans on bills is rendered doubly simple.

Loans upon bills of exchange are, in a word, loans which are essentially secure in themselves; they are of direct benefit to trade and industry even to the extent of operating to lower the cost of

the workingman's food supplies; they may be called without fear of reaction upon the lender, inasmuch as widely held investment securities are not involved; and they may be readily shifted to foreign banking institutions. The safety therefore with which banks lend their money on bills of exchange contributes to the effectiveness of the English banking system in meeting the primary requirements of low money rates and the maintenance of London's position as the financial center of the world. In the first place the assurance that its loans, or a considerable part of them, are liquid to an extraordinary degree enables a bank not only to lend at a low rate but lessens the necessity of maintaining a large cash reserve, which in turn means an addition to the supply of loanable capital with a tendency further to depress rates. In the second place it minimizes the danger of a collapse of the credit fabric such as we experienced in 1907. London's methods of lending are calculated to avert a similar situation so far as England is concerned, a situation in a material degree made possible by our practice of placing our almost sole reliance upon stock-exchange securities as collateral for day-to-day advances. Doubt as to the strength of certain banks led to withdrawals of deposits. Withdrawals of deposits made necessary the replenishment of reserves by the calling of loans. The calling of loans resulted in liquidation on the stock exchange. Falling prices of securities tended to spread alarm among investors generally, carrying with it further withdrawals of deposits, necessitating in turn the calling of other loans, until we reached the point when for practical purposes demand loans were little more callable than time loans. Unlike London we could not shift a part of our loans to Paris. The French banks saw a difference between bills of exchange with but a few weeks to run, and stocks and bonds the market value of which might be considerably less than the amount loaned within an equal length of time.

London's prestige rests as much upon its ability to withstand financial shocks, to ward off panics, to continue payments in gold at any and all times, as it does upon its great resources. In fact an important part of the resources which enable it to maintain low money rates and to handle great international loan operations is due to the position which it has so long occupied. Its bank deposits are not purely English. They are made up in part of foreign accounts, representing remittances from all quarters of the globe.

London cannot afford that these foreign deposits should be jeopardized. Their protection the English banking system has as one of its main objectives, and the success with which it has been accomplished rests in large measure on that practice of lending which has no place in our banking methods.

It is important to understand, however, that while English bankers have two classes of securities of different character, stocks and bonds and bills of exchange, on which to base their call loans, our bankers are of necessity confined to but one. The explanation lies in a further fundamental difference in the practice of lending. Briefly, it is that English banks lend their credit while our banks, national banks in particular, are prohibited by law from similar procedure. The practice also has its origin in that working principle of the English banking system, *i. e.* the safer bank loans and discounts can be made the lower can be the money rates afforded, and the cheaper England can buy and sell in foreign markets. The process is simple. When an English importer is about to buy materials in a foreign country he secures permission from his banker to have the bills of exchange drawn on him, the banker. In other words, for a small commission, the banker takes the place of the importer as the drawee and becomes, as the acceptor of the bills, responsible so far as any other banker is concerned, for their payment at maturity. These are the bills, bankers' bills as they are called, which are chiefly employed as a basis for short loans. These are the bills to which the Bank of England rate applies and which command the finest market discount rates, rates, in fact, usually lower than that of the Bank of England. Obviously the guaranty of a banker of high standing adds an important element of security to bills of exchange as a basis for the lending or investment of bank funds. It is an additional assurance to the foreign exporter that he can discount his bills at a low rate so that he can afford to make a favorable price to the English buyer. It makes them all the more satisfactory investments for foreign banking institutions.

The practice of lending by means of acceptances, so large a factor in the development of England's foreign trade and a substantial protection to the London money market, giving extraordinary security to loans and rendering more easy their partial shifting to continental institutions in times of stress, differs in no essential particular from the use to which credit is put in ordinary commercial

transactions. Apart from his financial resources the principal asset of a business man is his credit, founded upon the excellence of his judgment, his honesty, the carefulness of his methods and his past successes. It is a legitimate asset, one of which he is entitled to make use in securing accommodation from his banker. Under the English banking system, bankers are regarded as possessors of credit and are permitted to make use of it, to lend it. Under our system the credit of our banks is forbidden similar employment. Under our laws it is effectually locked up. There is something parodoxical about our prohibition of a practice of lending so important to English and so common with continental banks. When a bank loans its deposits it is loaning something which does not belong to it, something which it may be called upon to return any day. On the other hand, when it loans its credit, its good name, it is loaning something peculiarly its own, something indeed which in course of time may be lost but while possessed is not subject to withdrawal from day to day.

The extraordinary waste of bankers' credit in this country as compared with the effectiveness of its use under the English banking system is difficult to justify. The most plausible argument is that the use of such credit may very readily lead to its abuse. Aside from the fact that a similar argument applies to almost any device of marked utility, it must be admitted that continued prohibition of the practice of lending by means of bankers' acceptances, safeguarded as it may be by providing that such acceptances shall be given only in connection with mercantile transactions and that every bank-accepted bill of exchange shall bear on its face a clear indication of the nature of the security upon which it is based, is an expensive measure of protection against possibly only occasional instances of bad banking.

The capital and surplus of our banks now amount to something like four thousand millions of dollars. The resources of our national banks alone amount to ten thousand millions of dollars. The possession of such vast sums in part their own, in part entrusted to them, is an indication of the honesty of management, soundness of judgment as to risks, and past successes of our banking institutions. It is an indication of the extent of their credit, credit which according to English banking practice would, in part at least, be put

to work, but which with us takes no part in advancing the great economic processes of production and distribution.

In England the lending of credit by means of acceptances is practiced both by the joint-stock banks and merchant bankers, but in what proportion cannot be stated definitely as the latter publish no reports. There is, however, a considerable difference as to the ratio between capital and acceptances as regards the two classes of bankers. It is regarded as safe for merchant bankers to accept bills to an amount several times their capital. The acceptances of the joint-stock banks, on the other hand, average only about seventy per cent of their paid-in capital and surplus. Taking into account the small cash reserves of the joint-stock banks, the limitation of acceptances by our banks to their capital and surplus would seem to err only on the side of conservatism. On this basis the total waste of banking power under our present methods of lending would appear to be roundly $4,000,000,000. If we reduce this amount by one-quarter in order to leave out of account small institutions and those not actively engaged in commercial business, we still have a remainder of $3,000,000,000, or a volume of credit sufficient to provide a banker's acceptance for bills of exchange to cover our total annual imports of merchandise and still leave an unused balance of an equal amount, $1,500,000,000. In short, the unused credit of our largest and most powerful banks alone would be sufficient to guarantee all foreign drawn bills, giving them a value and standing not possessed by drafts on individual importers.

In discounts, as well as short loans, there is a sharp contrast between English and American methods. English discounts fall into two classes, bank bills and trade bills, the difference depending on whether or not the acceptors are bankers. The former are principally taken into account in the general discount market. The latter, under ordinary circumstances, are bills discounted direct by customers of banks with the banks where their accounts are kept. As they are not equally liquid assets they do not command as favorable rates as bankers' bills. A large proportion of the discounts of our banks, on the other hand, are made up of promissory notes, a class of paper occupying a much smaller place in English banking practice.

The distinction between promissory notes and bills of exchange, bankers' bills in particular, underlies much that is dissimilar in our

banking situation as compared with that of England. Bills of exchange, as has already been indicated, arise out of particular commercial transactions. They are evidences of definite purchases and sales of commodities. They refer to and generally carry with them control over specific shipments of goods. Their discount by a bank is essentially that of providing funds to carry through a single business operation, the satisfactory conclusion of which is within the scope of a banker's judgment. Such bills, for example, represent so much cotton or so much wheat, and the banker can determine for himself with reasonable certainty the probability of the success of the venture. It is not so with our commercial paper. The promissory notes which form the bulk of our bank discounts do not so far as the banker is concerned refer to specific transactions. They do not on their face evidence the character of the particular operations which have rendered necessary accommodation from a banker. Without such evidence there is always the possibility that instead of the discount of the paper partaking of the nature of a temporary measure to relieve a temporary need it in reality becomes a loan of capital for general employment in the business, capital which in an emergency might not be able to be withdrawn without disastrous consequences. When a bill of exchange is drawn at ninety days' sight against a shipment of merchandise there is every assurance to the banker who discounts it that he is not contributing to a possible lock-up of capital. On the other hand, the discount of a promissory note does not carry with it any guarantee that a renewal will not be asked for or arranged elsewhere. Furthermore, our practice of discounting promissory notes, as contrasted with the English practice of confining discounts in large measure to bills of exchange, in and of itself places no check on the volume of notes or paper which may be distributed among a number of banks by a single concern.

Unquestionably the barrier which our laws have raised against the practice of bank acceptances has had a great deal to do with restricting discounts to commercial paper. Moreover, there is reason to believe that the removal of present restrictions would give a decidedly different character to our discounts—that bank-accepted bills of exchange would to a large extent be substituted for promissory notes, carrying with them as they would the additional security of a bank guaranty and evidence of the temporary nature

of the transaction. Doubtless much of our commercial paper is based upon mercantile transactions which could as well be expressed in time bills of exchange, inland as well as foreign. While English joint-stock banks confine their acceptances to foreign drawn bills, their reason for discriminating against inland bills is not that the business is unsound. By accepting inland bills they believe it might be made to appear that they were short of cash else they would have made their customer a straight loan. Obviously such a consideration is not applicable to conditions in this country where banking capital is divided into much smaller units.

The substitution of bills of exchange for promissory notes would not involve any complicated change in our business practice. Instead of a New York importer buying goods in England, borrowing from his bank in order to provide funds to remit in payment, he would arrange with his bank to accept on his behalf time bills drawn on it by the English shipper, the documents to accompany the bills and to be delivered by the bank to the importer under a trust receipt or the goods warehoused by the bank and kept under its control until the importer had had time to dispose of them, within, of course, the period covered by the currency of the bills. Similarly, a St. Louis dry-goods merchant would arrange for his bank to accept bills of exchange drawn on it by a New York wholesale house which had sold certain goods to him. The New York bank, upon presentation to it of a formal letter of credit issued by the St. Louis bank to its customer in favor of the New York wholesale house, would immediately discount the bills. Furthermore, the issuance of a letter of credit would be in many cases unnecessary, owing to the facility with which the New York bank could secure telegraphic confirmation from the St. Louis bank that it would accept certain bills accompanied by certain shipping documents. In short, there is no apparent reason why the principles which govern foreign trade operations should not apply equally well to domestic, particularly in a country of the dimensions of the United States.

One of the most far-reaching effects of our practice of confining discounts to promissory notes is that such discounts become to a large extent fixed investments, fixed in the sense that they may not be readily transferred from one bank to another, from a country bank to its reserve agent, without adding to the liabilities of the former. This is primarily due to the fact that the security for the

ultimate payment of the paper is dependent upon the financial strength of the maker and that the paper carries on its face no indication that the original discount or subsequent rediscount do not constitute an over-extension of credit. Discounts of bank-accepted bills of exchange are of quite another character. Not only do such bills, with shipping documents attached, indicate the nature of the transactions they cover, but, what is more important, their endorsement adds nothing to their security. When a powerful London banking house has on behalf of one of its clients accepted certain bills of exchange, that is, guaranteed by means of its signature their ultimate payment, it is obvious that the endorsement of such bills by a small country bank for purposes of rediscount would add nothing to their security; and, adding nothing to their security, does not for all practical purposes involve any liability upon the part of such bank. Similarly if a great New York bank had accepted certain bills of exchange drawn on it, and a country bank had purchased these bills from a broker as a short-time investment, and, later, finding its needs for cash increasing, decided to rediscount the bills, it could do so without adding to its liabilities, except in the technical sense that if the New York bank failed to meet its obligation as to the payment of these particular bills, the country bank, having endorsed them, would have to take them up.

As far as a few of our largest banks are concerned, whether they did or did not rediscount would not alter the application of the principle involved to our banking situation. As a matter of fact London clearing banks do not rediscount bills with the Bank of England, although there is nothing to prevent their doing so except custom. They accomplish, as we have seen, somewhat the same end by lending on bills to bill-brokers who do rediscounting. The smaller clearing banks regard the custom as an unnecessary hardship. The large ones rivaling in resources the Bank of England itself, and possessing hundreds of branches which are in reality so many country banks, are not to be compared in the matter of rediscounts with the thousands of small banks in the United States.

In the last analysis, we find that, notwithstanding differences in geographical or physical conditions as between England and America, English methods of lending, though widely different from our own in certain fundamental particulars, are not such as would not bear adoption in this country. They appear rather to be

methods most likely to make bank discounts more liquid assets, most likely to increase the public confidence, both at home and abroad, in the soundness of our banking institutions by effectually dissociating our short loans from operations in speculative securities, most likely to give full play to our banking power, as expressed not only in tangible resources but in credit as well, most likely to stimulate trade and industry but making possible lower and less fluctuating interest rates, most likely to increase our ability to compete in the markets of the world, and most likely to inject into our banking system many of those elements of stability for which the English banking system is so renowned.

UTILIZATION OF BANK RESERVES IN THE UNITED STATES AND FOREIGN COUNTRIES

By Hon. George E. Roberts,
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The cash reserve feature of the banking systems of the United States, state as well as national, is peculiar to this country. Nowhere else is a fixed reserve required against deposits. The central banking institutions of Europe are commonly required to keep a certain minimum metallic reserve against their note issues, although there is a notable exception even to this in the case of the Bank of France, but in all foreign countries the question of a proper cash reserve against deposits is left to the discretion of the banker.

The practices and regulations of foreign banking systems are all characterized by this comparative indifference to deposits and emphasis upon the importance of the note issues. On the continent of Europe this may be accounted for in part by the fact that deposit banking is yet undeveloped to any such degree as it is in England or the United States, and the private cheque has not yet taken the place of circulating notes, as it has done to a great extent in these two countries. The common medium of payments in Germany and France is the bank note, while in England and the United States it is the private cheque. The custom of keeping a bank account is much more common in these two countries than anywhere else in the world, and this of course accounts in part for our being more interested in the security for deposits while elsewhere the interest is in security for the circulating notes.

But England, although like ourselves in the use of the bank account and cheque, is like the continental countries in its indifference to cash reserves for deposits. There, too, all emphasis is laid upon the convertibility of the bank note. So far is this true that when the constitution of the Bank of England was reformed in 1844 and provision was made that its issues above a certain amount must be fully covered by gold, the authors of the act seem to have thought the bank absolutely fortified against attack, although no provision had been made to meet a run by depositors. This weak-

ness developed within three years, in the panic of 1847, when the demands on the banking department were so heavy that its cash would have been exhausted had not the government authorities taken the responsibility of advising the bank management to disregard the restrictions of the act and issue notes to meet the emergency. Twice since then, the last time in 1866, the same policy has been resorted to, with the result that although the law has never been changed, public opinion has settled down to the conclusion that the restrictions upon note issues will always be ignored when cash is actually needed. To this day, however, no legal reserve against deposits is required of either the Bank of England or the joint-stock banks of that country, and neither in England nor any continental country do any of the banks except the Central Bank show in their published statements the amount of their cash holdings. In all of these countries the banks report their credits at the Central Bank as cash, and commonly they report cash, credit at the Central Bank, and money at call or short notice in one item. Their reliance is not upon cash reserves, nor even upon balances at the Central Bank, but chiefly upon their holdings of commercial paper of a class which the Central Bank will always take off their hands.

The national banking system of the United States originally required a fixed cash reserve against both deposits and outstanding notes, but in 1874 the note reserve in the individual banks was dispensed with,—and the five per cent redemption fund for notes was established in the treasury at Washington. This fund, however, although set apart for the current redemption of notes, is still included and counted in the required reserve for deposits.

No change has been made in the reserve requirements for deposits since the establishment of the system. Banks in what are known as the central reserve cities, of which there are now three, New York, Chicago and St. Louis, must keep cash reserves in their own offices equal to twenty-five per cent of their deposits. Banks in what are denominated the reserve cities, of which there are now forty-six, must keep reserves of twenty-five per cent, but one-half may consist of balances in the national banks of the central reserve cities. The other banks of the system must keep reserves of fifteen per cent, but three-fifths of these may be kept with the national banks of the reserve and central reserve cities. There is no penalty for the violation of these provisions, but the law forbids the making of loans

while a bank is below the requirement and authorizes the Comptroller of the Currency in his discretion to have a receiver appointed.

The law as to reserves is not, of course, enforced with the same uncompromising rigor as those provisions which relate to the fundamental principles of banking. Every comptroller, while acknowledging it to be his duty to see that the reserve requirements are respected and ordinarily observed, has recognized that their literal enforcement at all times is utterly impracticable. No bank can control the amount of its cash holdings, for it must pay cash on demand and can only replenish its reserves by reducing its loans, and conditions may be such that to stop making loans and attempt to force collections will not only make collections impossible but create a state of panic that will greatly stimulate cash withdrawals. It is now a recognized principle of banking all over the world that in a crisis the banks should lend freely to all responsible borrowers, and no comptroller of the currency has ever insisted that a national bank should refuse to make any loans while its legal reserves were impaired. They have contented themselves with exerting pressure for the restoration of the reserves as soon as reasonably possible. In fact the law has been construed as a grant of authority to the comptroller enabling him to supervise the reserves and keep them as nearly as practicable at the prescribed proportions.

The provision of the statute which allows the banks in the smaller towns and cities to keep a portion of their reserves in the reserve cities, and the reserve city banks to keep a portion of their reserves in the central reserve cities, has been often criticised, and several secretaries of the treasury have recommended its repeal, but it simply recognizes the fact that banks are obliged to keep important cash balances in the central cities and that they pay off their depositors by means of these balances as well as over their own counters. The country banks would have to maintain balances in these cities whether the law allowed them to count in the reserves or not, in order to furnish exchange to their customers. And while these balances are sometimes larger than would be required by the needs of their exchange business, the surplus represents money not needed at home, and there is as good an argument in favor of gathering the idle capital of various localities into a central pool, where it will be available for other sections of the country which may have a seasonal use for it, as there is for gathering the idle

hoards of individuals into banks. This feature of our law is an approximation to the banking practices of other countries, and of course accomplishes a very important modification of the reserve requirements.

It is safe to say as a rule that the country banks and banks of the reserve cities carry more cash in vault than the law requires and would carry no less if there was no legal requirement. They carry considerably greater cash reserves than similarly situated banks in other countries, and feel obliged to because they do not have the same certainty of help from outside in an emergency. On the other hand, the banks of our central reserve cities, which must furnish the final support for the whole system in an emergency, run with much smaller reserves than the central banking institutions of Europe are accustomed to carry, and it is in this scattering of reserves as compared with their concentration in foreign systems that the weakness of our system appears.

The law contemplates that the banks of the central reserve cities shall hold the final reserves of the national banking system and in this respect have a relationship to the other banks similar to that of the central banks of Europe to the other banks there. But with us there is no such concentration of responsibility or special equipment for supporting the situation as there is over there. The national banks of our central reserve cities have no privileges or advantages or special powers. The number is in no way limited; there are many of them, and they are under the stress of sharp competition not only with each other, but with the state banks and trust companies in their own cities and with the banks of rival cities. It has been demonstrated that no agreement to cease paying interest can be maintained under the pressure of these conditions, and this fact alone puts them in a radically different position from the state banks of Europe. None of the latter pays interest and all agree that the practice is inconsistent with the conservative policy which should be followed by a bank holding the final reserves for a country. It is impossible to pay interest on deposits and keep the proportionate reserves that a bank carrying this responsibility should keep.

The Bank of France, at the date of its latest statement,[1] held in cash $860,492,329 against a total of all liabilities, including notes

[1]June 23, 1910.

and public and private deposits, of $1,166,368,451, or a reserve of seventy-eight per cent. This illustrates its deliberate and consistent policy, and makes plain why the other banks of France may implicitly rely upon it for assistance and need carry only small supplies of cash themselves.

When the National Monetary Commission was in Europe in 1909, seeking information from the leading financial authorities about the banking systems and practices of the different countries, it held interviews with M. Pallain, Governor of the Bank of France, and with the heads of the principal joint-stock banking companies of Paris, in which the relations of the Bank of France to these other institutions were clearly developed. The following is an extract from the interview with M. Pallain:

Q. The published balance sheets of the banks do not state separately the amount in the Bank of France and the amount in their own vaults.

A. In the credit establishments which you will visit you will be able to establish the fact that the liquid cash is, in comparison with their turnover, relatively very small. In France we consider that the strength of a bank consists more in the composition of its portfolio, *i. e.*, in the value of its commercial bills, rather than in the importance of its cash reserve.

Q. In America the question of the proper relation between cash in hand and liabilities is considered very important.

A. It appears to us that for French private banks the proportion of cash to liabilities is less significant on account of the facilities offered by the organization of the Bank of France for the rapid conversion—in a crisis—of a good portfolio into ready money.

Q. We are trying to inform ourselves as to the usages and customs of foreign banks. It is for this reason that we seek to ascertain the percentage of cash which the banks hold to their deposit liabilities.

A. I think I have already replied on this point. The part which the Bank of France plays toward the private establishments permits the latter, as has many a time been proved, to reduce to a minimum their cash reserves, and to devote, without exceptional risk, a larger part perhaps than elsewhere to productive commercial operations.

In an interview with Baron Brincard, of the Credit Lyonnais, an institution with approximately $300,000,000 of deposits, the following questions and answers occurred:

Q. Is it customary for you to carry quite a large amount of cash in your vault?

A. Every day the amount of cash which is to be kept here in our

vaults is fixed according to the payments to be made during the day. Sometimes our holdings are greatly in excess of our forecast for disbursements. This happens when we do not find ready use for amounts available.

Q. You would not carry a larger amount of cash in vault than required by your daily needs in order that it may serve as a part of your reserve?

A. There is no legal requirement for a reserve in cash; the bank is quite free to keep the amount of cash that it judges necessary. It is the practical business experience of many years which indicates how much cash is needed for the day.

Q. So the cash in hand is merely carried for the necessities of business?

A. Yes; this is the point on which the French situation is quite different from the American, because in France bankers are free to have in their vaults any amount of cash they like. In France we have the Bank of France which regulates the currency of the whole country, and any bank, if it has need for additional cash, may present for rediscount at the Bank of France the bills and other commercial paper which it has in its vaults. The amount we carry in the Bank of France may vary greatly according to circumstances. It is not to our advantage to have too large a sum at the bank, because the Bank of France does not allow any interest.

Q. What per cent of your deposits do you intend to carry in cash either in your own vaults or in other banks?

A. Eight to ten per cent on the average. The excess of deposits is invested almost entirely in commercial paper available for discount with the Bank of France at any moment and in "reports" (loans or securities from one stock exchange settlement to another).

Q. You have nearly ten per cent in this statement?

A. That is perhaps more than we need. It is a matter of practical experience. There is no legal proportion.

It will be seen that the percentage of cash kept in the bank's own vaults is not given, but its cash and cash balance at the Bank of France were together eight or ten per cent of its deposits. The commission went further into the availability of the short time commercial paper as a banking reserve, as follows:

Q. If the Credit Lyonnais were to take bills to the Bank of France for rediscount, would the Bank of France scrutinize those bills beyond the number of signatures and the time they have to run?

A. It would scrutinize the number of signatures and the time. In every branch of the Bank of France there is a committee called the discount committee, which is charged to make inquiries as to the quality of the industrial and business men of the region, and on their advice those persons are or are not admitted to discount. When once a person is admitted to discount the question of his credit is not raised every time that he presents a bill for discount; but if he should offer too many bills the bank would doubtless call

his attention to the fact. In practice no one has ever complained that the Bank of France would not discount a normal bill presented by a proper person.

Q. As a matter of fact, bills offered by the Credit Lyonnais would not be investigated very carefully?

A. No.

Q. You regard that item of bills discounted as your practical reserve because of your ability to rediscount the bills at the Bank of France?

A. Yes; bills discounted and cash are, for an establishment such as ours, the most essential part of our liquid assets.

In the interview with M. Ullman, Director of the Comptoir d'Escompte, another great French institution, the following colloquy occurred:

Q. Is the Bank of France your principal reliance in case you need money? Do you think it necessary to carry any additional reserve?

A. Under our French system we consider the commercial paper we keep in the portfolio a cash reserve, as we can rediscount it at the Bank of France. We know the Bank of France will discount these bills and thus enable us to convert the bills instantly into cash; this is the basis of the French banking system.

The Imperial Bank of Germany, or Reichsbank, performs practically the same functions in Germany that the Bank of France does in France. It does not run ordinarily with as strong a cash reserve, for the position of the Bank of France is unique and due in part to the peculiar position of France as a creditor nation with a constant influx of gold. But at the date of the latest statement available at this writing, the Reichsbank held cash reserves equal to seventy-five per cent of its outstanding notes, and above fifty per cent of all liabilities, including the government deposits. In an interview with the Monetary Commission last year, the vice-president of the bank stated that the lowest point ever touched by its reserve was 40.3 per cent, at the close of 1905.

There are no restrictions upon the power of this institution to issue notes except the requirement that a reserve of thirty-three and one-third per cent of cash shall be held against them and the levy of a five per cent tax upon the excess above a certain amount. And even this reserve requirement, like that of the Bank of England and that of the national banks of the United States, is not to be taken too literally, for when the Monetary Commission asked Herr

Dr. von Glasenapp, vice-president, what the bank would do if the reserve fell to thirty-two per cent, he replied:

> We should have to go on discounting bills. We should simply have to do it. We could not stop it. If we did it would bring on the greatest panic that we ever experienced.

In other words, the Reichsbank recognizes its responsibility as the keeper of the final banking reserves, and will not cease in a crisis to supply credit and currency to meet the needs of the other banks of the country. This attitude gives absolute confidence to the public.

In the interview held by the Monetary Commission with Herr Paul Mankiewitz, director of the Deutsche Bank, he said:

> The great strength of our financial system in Germany is the Reichsbank. Under that system the question of our own cash reserve is of secondary importance, as we can at all times convert our holdings of commercial paper into cash at the Reichsbank. I may mention that of the prime commercial bills we are carrying from $1,500,000 to $2,000,000 fall due each day; for these we get cash or credit at the Reichsbank at maturity. It is our usual practice to keep in vaults and banks a considerable amount of cash, often more than ten per cent, and sometimes less, perhaps eight per cent.

This reserve of eight or ten per cent, including cash in bank and credit at the central bank, corresponds to similar figures in France.

In England the practice of counting balances with the central bank as a part of the cash resources prevails as on the Continent, and the other institutions as a rule carry only so much cash in their own offices as they estimate will be needed to meet current demands. Of late, however, a considerable body of opinion has developed to the effect that the burden of providing the gold reserve for the London market is too great to be thrown upon the Bank of England alone. London is the chief international clearing center and the transactions in gold there are very much more important than in any other market of the world. A financial disturbance in any country causes a demand upon London for gold, and it sometimes comes with alarming insistence, as in the case of the American demand of 1907. Although there is no complaint that the Bank of England has not ably and effectively performed the functions

which belong to a central banking institution, the importance of London as the banking and clearing metropolis of the world, has developed so enormously, that the bank has become a relatively smaller institution than formerly, having been passed in volume of business and assets by several of the joint-stock banks. Under these conditions, it has been urged that the other banks should bear some part of the burden of protecting the London market from the unusual demands to which, by reason of its international relations, it is exposed, and some steps to this end have been taken. The average reserve of the banking institutions which center in London, in cash and balances at the Bank of England, have been estimated at fourteen to twenty per cent. As the Bank of England's reserve is from forty to fifty per cent, the average of cash in bank to the total of individual deposits in Great Britain is probably eight or ten per cent.

In the United States, taking only individual deposits in order to avoid duplication, the total for all banks is reported by the Comptroller of the Currency on April 28, 1909, in round numbers as follows:

National banks	$4,826,100,000
State banks	2,466,900,000
Savings banks	3,713,400,000
Private banks	193,300,000
Loan and trust companies	2,835,800,000
Total	$14,035,500,000

The cash holdings were as follows:

National banks	$926,800,000
State banks	227,000,000
Savings banks	32,700,000
Private banks	11,100,000
Loan and trust companies	254,400,000
Total	$1,452,000,000

or about ten per cent. The actual percentage of cash to liabilities does not appear to be very different from what it is in the three countries reviewed above, but there is no denying that a more effective utilization is obtained in every one of the three than in the

United States. We have more money in the individual banks, but no final banking reserve of sufficient strength to inspire confidence. The ability of the final supporting power, be it a single bank or a group of banks, to give aid to the other banks of the system in a crisis, lies of course in the resources kept ordinarily in reserve. The central reserve banks of our national system are required to keep a reserve of twenty-five per cent and forbidden to make any loans when they are below this figure. Granting that this inhibition is not strictly enforced, it remains true that they are under pressure to maintain their reserves at this point. How much surplus reserve do they usually have above it? The following are the percentages of each city at the date of every official statement from August 22, 1907, which was the last statement preceding the panic:

	New York.	Chicago.	St. Louis.
August 22, 1907	26.81	25.34	23.59
December 3, 1907	21.89	24.21	20.38
February 14, 1908	29.00	27.14	28.98
May 14, 1908	30.52	26.82	28.86
July 15, 1908	28.37	26.59	25.52
September 23, 1908	28.65	25.12	25.41
November 27, 1908	26.02	25.94	25.71
February 5, 1909	25.58	25.99	26.52
April 28, 1909	25.68	26.16	25.44
June 23, 1909	27.27	25.73	25.21
September 1, 1909	25.83	24.30	24.72
November 15, 1909	25.52	24.29	24.80
January 31, 1910	26.64	24.12	24.05
March 29, 1910	25.76	23.35	22.36

These figures show practically no surplus reserves. It is true that all of these banks have a considerable proportion of their loans at call or upon short maturities and any one of them would be able to liquidate rapidly under normal conditions, when it was the only one under pressure. But when a general situation develops and there is a common movement to liquidate, there are no other resources in this country to draw upon and nothing to be done but to sell securities or products or negotiate loans abroad, any of which is a slow and costly process of getting relief in a crisis.

The scattered reserves in local banks are of no avail in a panic. Whether they average five per cent or twenty per cent makes little difference, for the banks that are strong feel none too strong and

will hoard every dollar. Gathered into a central fund they would aggregate a sum great enough to inspire confidence and could be brought to bear at the point of danger to protect every situation.

The most serious result of this fundamental weakness at the center is the lack of confidence which pervades the whole system and the readiness on the part of thousands of individual banks to take alarm and do, for the purpose of self-protection, the very thing that precipitates a crisis. The general suspension of cash payments in 1907 was unnecessary. Outside of New York City depositors were not alarmed but taken completely by surprise by the emergency measures adopted. The natural impulse of the scattered banks to strengthen themselves forced a suspension of payments in the reserve cities and literally broke down the system.

The essential thing required to prevent or allay panics is knowledge that there is a central reserve of credit strong enough to provide every solvent bank and business house with ample support. Periods of industrial reaction and of speculative collapse are bound to come occasionally in every country. Private credit is strained at such a time, solvency is put to the test, and the unsound concerns are weeded out. It is of supreme importance at such a time that banks and business houses which are really solvent shall not be broken down and destroyed through inability to obtain the ordinary consideration to which their assets entitle them. There is literally no limit to which disorganization may go unless there is some power strong enough to stay the panic by interposing its undoubted credit to protect the firms and concerns that it finds to be worthy. This fund of credit the great central institutions of Europe afford, but the machinery of our national banking system does not supply.

The Bank of France and the Reichsbank have the power of actually increasing the supply of money in the country. The Bank of England does not have this power by statute, but as we have seen has three times exercised it, and these instances have satisfied the public that it will be exercised whenever it is necessary. The ability to draw checks on the central institution is all that the banks of any country in Europe ordinarily require to meet the demands upon them.

We have already in the United States a gold reserve great enough to be made the basis of an institution more powerful than any one of those which have been named. The treasury held in the

division of redemption on the 1st day of July, 1910, a reserve of $862,936,869 in gold coin against outstanding demand certificates of exactly the same amount. The volume of these certificates is always completely covered, and as a government issue properly so. If, however, an institution designed to support the credit system of this country was created, and its notes were made available for the same purposes for which gold certificates are used, they might be substituted for the latter in circulation. In doing so, the treasury certificates would pass into the hands of this new organization and be presented at the treasury for redemption. Thus the reserve would be transferred to the new institution and, starting with a reserve of one hundred per cent, it could take a place in and behind the banking system of this country similar to that held by the great central institutions of Europe in their systems.

The only problem about it is to provide an organization that will be acceptable to the country as giving assurance that the institution will be kept out of politics and not fall under the control of private or special interests. It is generally recognized that the best way to accomplish this is by keeping the management in the hands of the bankers of the country. The capital of the bank, say $100,000,000, might be raised by selling the stock under a guaranty by the government of a low rate dividend, say four per cent. But, if the stock is sold broadcast the control should be taken away from it, and might be vested in a board of directors elected by the leading clearing houses of the country. Suppose the first twenty-five or thirty clearing houses leading in clearings for the preceding year were incorporated and each allowed to elect one member of a board: Based on the clearings of the first six months of 1910 the membership would then be distributed over the country as follows: Boston, New York, Baltimore, Richmond, Buffalo, Cleveland, Chicago, Milwaukee, St. Paul, Kansas City, Louisville, New Orleans, Denver, Los Angeles, Portland, Providence, Philadelphia, Washington. Pittsburg, Detroit, Cincinnati, Indianapolis, Minneapolis, Omaha, St. Louis, Atlanta, Houston, Salt Lake, San Francisco, Seattle.

Another plan suggested is to distribute the stock with the local banks of the country on the basis of their capital. The national banks could be either required to subscribe or offered inducements to do so, and if they paid in ten per cent of their capital that would provide about $100,000,000. The directors should be elected by dis-

tricts, so that every section of the country would be represented on the board by a member of its own choosing. Under either of these plans the board of directors would have, through the personal knowledge of its members, all of whom would be bankers of high standing, the most thorough acquaintance with business conditions over the country that could possibly be obtained. Each member would be there as the representative of the bankers of his locality and the bankers of every locality are so closely identified with all its business interests that the latter would be safe in their hands.

The members of the board would naturally be divided in their political affiliations and there is no more reason to believe that political considerations would influence their action than there is to expect the clearing houses to suddenly become political agencies.

The active and responsible officers of the bank should be chosen by this board, but to satisfy public opinion and because of the intimate relations which this institution would bear to the treasury, there may well be another board, supervisory in its functions, representing the government. It might consist of three important officials of the Treasury Department and perhaps two outside members of banking experience, appointed by the President. It would doubtless be advisable to divide the profits between shareholders and the treasury on some such plan as exists in Germany, Austria-Hungary and elsewhere.

It would not be necessary or desirable to have this central institution do a general banking business with the public, or to even hold the reserves of the local banks. It should be established with the slightest possible disturbance of existing banking conditions. For it to undertake to hold the reserves of country banks would involve an enormous shifting of funds from present channels, and, what is more serious, cause a concentration of loanable funds which is distinctly undesirable. The resources of the proposed Central Bank are to be kept largely in reserve. If the present reserves of country banks are taken from the city reserve agents, who now hold them and loan them, and transferred to a central institution which will keep them mainly in reserve, there will be a very heavy and unnecessary loss of working capital to the country. The relations of the country banks to their present reserve correspondents should not be disturbed, but back of the reserve cities and central reserve cities there should be the new central institution

holding the concentrated gold reserve as the basis for a great fund of credit which may be drawn upon as needed.

The country banks should not only be encouraged to keep their reserve or surplus funds with their city correspondents as heretofore, but should be encouraged to get their accommodations there as well. There are forty-six reserve cities and many other important towns where the banks actually carry reserves for smaller banks in nearby towns and make loans to them. These relationships have developed naturally, are based upon intimate acquaintance, and should not be disturbed. Let them all be part of a system at the head of which shall be the Central Bank of Issue. By the use of all these agencies the distribution of credit can be more effectually secured than by attempting to have all of the small banks of this great country do business directly with the Central Bank.

Nor is it necessary or desirable to retire the bond-secured currency, at least at the present time. It is a practically fixed amount and serves the purpose of a circulating medium. To retire it would involve refunding the outstanding two per cents and, what is more serious, it would involve providing $700,000,000 of currency to fill the void in our currency stock. Future issues of government bonds should be on an investment basis, but the outstanding national bank issues may well be left undisturbed until the bonds upon which they are based are retired.

One of the most important services which a Central Bank could render would be that of handling the treasury funds. The present practice of distributing them, arbitrarily, among the national banks is a continual vexation to the Secretary of the Treasury, subjecting him to constant importunity and criticism. And there is no way of relieving him except by creating a strong responsible agency which shall have such relations to the banking and commercial community that it can handle the large and rapidly growing receipts and disbursements without disturbance.

The common objection to a Central Bank of Issue, *i. e.*, that it would be related to Wall Street and become involved in speculative transactions, is made without knowledge of the functions and practices of such institutions elsewhere. Nowhere are stocks or bonds permitted to be used as the basis of note issues. Everywhere short time commercial paper, representing actual commodities moving to market or in process of production, is required. Wall Street has no

means of creating such paper. A ninety-day bill of exchange, drawn by a Minneapolis milling company and accepted by a solvent merchant, based on a car load of flour, cannot be duplicated in Wall Street. We show our ignorance of world methods when we profess our inability to discriminate between legitimate banking and stock company promotion, or our inability to safeguard the former from the latter. And it is not too much to say that such a state of financial deadlock as existed in the United States in 1907 is a reflection upon the intelligence of the American people and of their moral capacity to do business by the most advanced methods.

THE CANADIAN BANKING SYSTEM AND ITS OPERATION UNDER STRESS[1]

By Joseph French Johnson,
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A. Introduction

Financially Canada is part of the United States. Fully half the gold reserve upon which its credit system is based is lodged in the vaults of the New York Clearing House. In any emergency requiring additional capital Montreal, Toronto, and Winnipeg call on New York for funds just as do St. Paul, Kansas City, and New Orleans. New York exchange is a current and universal medium in Canada and is in constant demand among the banks. A Canadian wishing to invest in securities that may be quickly marketed commonly turns to the New York market for stocks and bonds. Yet the American banker visiting in Canada, if he is unacquainted with the history of banking in his own country, finds himself in a land of financial novelties, for Canada has a banking system unlike any in operation in the United States at the present time. Twenty-nine banks, known as the "chartered banks," transact all the banking business of the Dominion. They have 2,200 branches, and each may establish new branches without increase of its capital stock. They issue notes without depositing security with the government and in such abundance that no other form of currency in denominations of $5 and above is in circulation. Notwithstanding the fact that the notes are "unsecured," their "goodness" is unquestioned among the Canadian people.

But to the student of the history of banking in the United States there is little that is radically new in the Canadian system. He finds in it many of the practices and expedients that were found excellent in the United States in the first half of the nineteenth century, and is almost persuaded that but for the Civil War what is

[1]This paper is taken, with the consent of the author, from a recent report on "The Canadian Banking System," prepared by Professor Johnson for the "National Monetary Commission." The report has just been published by the commission.

now known as the Canadian banking system would everywhere be called the American system.

The fiscal exigencies of war, which have caused changes in the banking systems of most countries, have had no influence upon the development of banking in Canada. During the first half of the nineteenth century the commercial and financial interests of Canada and the United States were comparatively intimate and the financial institutions of both countries developed on similar lines. The safety-fund system, first introduced in the State of New York in 1829, found favor also in Canada and is still an integral part of the Canadian banking system. Branch banking, which was most successfully illustrated in this country by the Bank of Indiana, and which now exists in some form or other in almost all countries except the United States, has always prevailed in Canada. The importance of a prompt redemption of bank notes as exemplified in the old Suffolk banking system in New England before the war, was fully realized in Canada and is probably better illustrated in the present Canadian system than in any other country. There bank notes and bank checks are treated as identical in nature, both being cleared with the same regularity and promptness. The so-called free banking system, which was first adopted in the State of New York in 1839 and thereafter adopted by eighteen other states of the Union, was tried in Canada in the fifties, but not on a large scale. This system, requiring that issues of bank notes should be secured by a segregated deposit of certain classes of stocks and bonds, has never met with approval among the leading bankers of Canada.

The Canadian system is a product of evolution. It has taken its present form because of the commercial and financial needs of the Canadian people. It was not created by lawyers or statesmen to meet a fiscal need of the government, but has grown up gradually under the fostering care of experienced bankers, no changes having been made until experience proved them necessary or advisable. The business interests of the Dominion, through their representatives in the provincial legislatures and in the Dominion Parliament, have had much to do with its development in a natural effort to protect the rights of the borrower, the depositor, and the note holder. The banks do not possess all the privileges many of the bankers would like to have, nor do the business men of Canada believe in the real necessity for all the protection given to the banks

by the law, yet in the main the system is satisfactory both to bankers and to their customers.

The chartered banks transact the business which in the United States is divided among national banks, trust companies, private banks, and savings banks. They buy and sell commercial paper, discount the notes of their customers, lend money on stocks and bonds, make advances to farmers, and sometimes aid in the financing of railroads and industrial enterprises. To a Canadian the word "bank" means one of the twenty-nine "chartered banks," for the law prohibits the use of the word "bank" by any other institution.

Monetary System

Canada's monetary system is substantially the same as that of the United States. The unit is the dollar of 23.22 grains of pure gold. The gold coins of the United States are legal tender in Canada. So is the British sovereign, which is rated at $\$4.86^2/_3$. Until recently all Canadian coins were minted in either England or the United States, but in 1908 a branch of the British mint was established in Ottawa.

The paper currency of Canada consists of Dominion notes and bank notes. The former are issued by the government under authority of the "Dominion notes act," which permits an unlimited issue, requiring security as follows: That for $30,000,000 of the notes outstanding the minister of finance shall hold in gold and government securities a reserve equal to twenty-five per cent of the issue, the amount held in gold to be not less than fifteen per cent of the amount of notes outstanding; and that against all notes issued in excess of $30,000,000 the minister shall hold an equal amount of gold. The framers of the act evidently had in mind the limitation placed upon the Bank of England's issue of notes by the Peel act of 1844. The Dominion notes, accordingly, are gold certificates rather than credit notes. The minister of finance is required to redeem the notes in gold at branches of his department in several different cities. If need be, the minister may sell bonds to obtain gold for use in the redemption of the notes.

Dominion notes are legal tender and may be issued in any denominations, but experience has proved that they are most needed in bills of large denominations for use in banking reserves and in the form of $1 and $2 bills, the banks not being permitted to issue

notes under $5. The average circulation of Dominion notes in 1908 amounted to $68,602,944, of which amount $52,882,708 was in $500, $1,000 and $5,000 bills, and $14,910,365 in $1 and $2 bills. There has been a pretty constant increase in the amount of Dominion notes outstanding. In 1900 the total was only $26,550,465. The bills of large denominations are practically all carried by the banks in their reserves.

Canadian banks are not permitted to issue notes of a denomination less than $5. Of fives and multiples thereof they may issue an amount equal to their paid-up capital without deposit of security and without payment of tax. As a result the currency in the hands of the people consists almost exclusively of bank notes. The amount in circulation increased from $50,000,000 in 1900 to $81,400,000 in 1909.

B. Essentials of the Canadian Banking System

A chartered bank in Canada is a bank of branches, not a bank with branches. The parent bank, technically known as the "head office," neither takes deposits nor lends money. All the banking business is done by the branches, each enjoying considerable independence, but all subject to the supervision and control of the head office. The law places no restrictions upon the number or location of branches. Canadian banks, therefore, have branches in foreign countries as well as in Canada.

The general bank act, under the terms of which every bank obtains and holds its charter, is subject to revision every ten years. In its present form it is substantially as passed in 1890.

Process of Incorporation

The provisions of the bank act with respect to the organization of new banks are intended to guard against the entry of unfit or inexperienced persons into the banking business. The minimum required capital of a bank is $500,000, of which all must be subscribed and one-half paid in before a new bank can open. At least five men of integrity and good financial standing must agree to act as provisional directors and secure a favorable report on their project from the parliamentary committee on banking and commerce. These men must agree to subscribe for fairly large blocks of stock, otherwise the committee will be inclined to reject their

application. They must convince the committee that their project is a well-considered one, that there is need for the new bank, that it is a bona fide enterprise, that they have in mind a competent man for general manager, that they really intend and expect to do a legitimate banking business. If they satisfy the parliamentary committee it will be granted. The bank, however, can not yet begin business. Provisional directors now have merely the right to advertise and cause stock books to be opened. If inside of one year capital stock to the amount of $500,000 has been subscribed and $250,000 thereof paid in, the provisional directors may call a meeting of the shareholders, at which a board of regular directors shall be chosen. Before this meeting is held at least $250,000 in cash must be paid over to the minister of finance. The regular directors must then apply to a body known as the treasury board[2] for a certificate permitting the bank to issue notes[3] and begin business and the treasury board may refuse this certificate unless it is entirely satisfied that all the requirements of the law have been met.

Having obtained its charter, a new bank must open its head office in the place designated, and may then proceed to establish branches or agencies, upon the number and location of which the law places no restriction. Under its charter it has authority to do a general banking business; it may discount commercial paper, lend money on collateral security, accept deposits payable on demand or after notice, and issue circulating notes up to the amount of its unimpaired paid-up capital in denominations of $5 and multiples thereof. An amendment of the bank act passed July 20, 1908, gives the bank the right to issue what may be called an emergency circulation during the crop-moving season (October 1 to January 31). During this period the legal maximum of the circulation of a bank is its paid-up capital plus fifteen per cent of its combined paid-up capital and surplus or rest fund. The emergency circula-

[2]The treasury board consists of the minister of finance and five ministers nominated from time to time by the governor in council. The minister of finance is chairman of the board and the deputy minister of finance ex officio the secretary.

[3]The designing and engraving of the notes is left with the bank itself. Many of the banks have had their notes made in the United States, but a bank-note company has been established in Canada and is getting a larger proportion of this business every year. The notes must bear the signatures of two officers of the bank. The authority to sign, however, may be delegated to subordinates. When notes are shipped by the head office to a branch they are usually sent with only one signature, the other being supplied by one of the branch offices. If the notes should be lost or stolen en route they are worthless.

tion, which consists of notes in form and in other respects exactly like the regular issues, is subject to a tax at a rate not to exceed five per cent per annum, the rate being fixed by the governor in council. If a bank's circulation does not exceed its paid-up capital, it pays no tax.

Security and Redemption of Notes

The law is silent on several subjects that seem of great importance to most bankers in the United States. For instance, it does not require that the banks shall deposit with a government official, or in any way set aside any kind of security for the protection of the note holder. It does not even require that the banks shall carry a cash reserve against either notes or deposits, nor does the law make the notes a legal tender for any payment. A bank need not accept the notes of other banks. The government does not guarantee the redemption of the notes. Neither does it bind itself to receive them in payment of dues to itself.

Nevertheless the notes of the Canadian banks are everywhere acceptable at par, the people apparently not being at all concerned about their "goodness." And their confidence in the note has been well justified, for nobody since 1890 has lost a dollar through the failure of a bank to redeem its notes. Following are the legal requirements, which for twenty years have proved adequate protection for the note holder:

1. Every bank must redeem its notes at its head office and in such commercial centers as are designated by the treasury board. The redemption cities are the same for all the banks. They are Toronto, Montreal, Halifax, Winnipeg, Victoria, St. John, and Charlottetown.

2. Each bank must keep on deposit with the minister of finance a sum of lawful money (gold or Dominion notes) equal to five per cent of its average circulation; the total so deposited is called the "circulation redemption fund." It is a guaranty or insurance fund for use, if need be, in the redemption of the notes of failed banks.

3. Bank notes possess first lien upon the assets of a bank.

4. Bank stockholders are liable to an assessment equal to the par value of their stock.

5. A bank must make to the minister of finance on or before the fifteenth of each month a detailed statement of its assets and liabilities on the last business day of the preceding month. This monthly

return, the form for which is set forth in the act, must be signed by three general officers.

6. The Canadian Bankers' Association, an incorporated body of which each bank is a member, is given supervision by the bank act of the issue and cancellation of notes and of the affairs of a failed bank.

7. The notes of a failed bank draw interest at five per cent from the date fixed for their redemption by the minister of finance, who may redeem them out of the assets of the bank or out of the "circulation redemption fund."

Importance of Redemption

Each of these provisions of the law has its value and significance, but only the first is absolutely essential to the successful operation of the system. All the other provisions might be changed or abolished without impairment of the efficiency of the banking system. But the abolishment of this redemption system would at once give Canada a new banking system. The bank note is almost the sole circulating medium in Canada, and the people have confidence in it because it is tested every day at the clearing houses and proves itself as good as gold. This daily test would probably not take place with the same regularity as now if the banks did not have branches or if they were obliged to deposit security against their issues. Canadian banks are national, not local institutions. All but a few of them have branches in every part of the Dominion, and these branches, as fast as they receive the notes of other banks, either send them in to the nearest redemption center or convert them into lawful money—or its equivalent, a bill of exchange—through branches of the issuing banks located in the same towns. The twenty-nine chartered banks have 2,200 branches and each bank is seeking, through its branches, to satisfy all the legitimate needs of the people for a circulating medium. When the note of a bank is in circulation it is earning money for the bank, but when it is in the vault or on the counter of the bank it is an idle and useless piece of paper. Hence every bank always pays out its own notes through its branches and sends the notes of other banks in for redemption, thus increasing its own circulation and strengthening its own reserve.

Furthermore, if the banks were not allowed complete freedom

of issue within the prescribed limit, but were required to deposit some form of security, as is required of the national banks in the United States, an investment or speculative risk would arise that would inevitably cause friction. If bonds were designated as security, bankers might often be tempted by high prices to sell their bonds and forego the profit on circulation for the sake of making a larger profit by the sale of the security. Thus the volume of bank notes might contract even at a time when the people needed more currency. In such case, of course, Canada would be obliged to import gold in order to fill the gap in the circulating medium.

The Circulation Redemption Fund

The five per cent insurance fund for the redemption of the notes of failed banks is theoretically an important and prominent part of the system, yet practically it would seem to be of little consequence, for not once since 1890 has it been necessary to use a dollar of the fund. Banks have failed, to be sure, but the notes of these banks have always been redeemed either out of the assets or by recourse to the double liability of the shareholders. It is a mistake to suppose that the people of Canada have confidence in bank notes because of the existence of this redemption fund. The average business man knows nothing about the fund and if his attention were called to it as being a source of security for the bank notes he would probably think a five per cent reserve altogether too small. The real reason why the people have faith in bank notes is because the notes are always honored by the banks and never fail to stand the test of the clearing house. In other words, they believe that bank notes are good for about the same reason that they believe the sun will rise in the east every twenty-four hours and do not bother themselves about reasons.

Nevertheless this redemption fund does contribute to the strength of the banking system. It makes each bank to a certain extent liable for the mistakes of other banks, and as a result gives rise to a spirit of mutual watchfulness and helpfulness. Other features of the system contribute to the same result, especially the fact that a Canadian bank accepts from a depositor without indorsement the notes of other banks. Since the banks have branches in agricultural and mining communities, often distant from the railroad by several days' journey, and these branches are accepting the notes

of other banks and giving credit for them as if they were gold itself, it is evidently important that each banker should have all possible information with regard to the status and business of his competitors. As a result one finds among the bankers of Canada a surprisingly intimate knowledge of each other's affairs.

Two Negative Qualities

The two negative qualities of the Canadian bank note—its lack of a legal-tender quality and of a government guaranty—at first sight may seem to readers in the United States a source of weakness. Yet Canadian bankers would doubtless all agree that nothing would be gained by making bank notes legal tender for any kind of payment or by making the government in any measure liable for their ultimate redemption. Such measures would probably be rejected as likely to prove harmful. It would be like hampering a flying machine with unnecessary bars of steel. Bank notes, like bank checks, are mere promises to pay money and are more convenient than money because they can be created as need for a medium of exchange arises. When either has done the work that called it into existence, it should disappear from circulation and be redeemed. If it is made a legal tender like money itself, or if its redemption is guaranteed by a strong government, there is always the danger that ignorant classes of people will regard it as money itself and withdraw it from circulation.

The Canadian government has nothing to do with the daily redemption of bank notes and does not guarantee that they shall be redeemed. It is custodian of the five per cent redemption fund and is under obligation to redeem the notes of failed banks out of this fund, but if a series of bank failures should exhaust it the note holder has no guaranty that government funds will be used for his relief.[4]

The possession by the note holder of a first lien upon the assets of a bank, including the funds that may be collected from shareholders on account of their double liability, gives rise to such general confidence in the ultimate convertibility of a bank note that the notes of a failed bank, on account of the interest they bear, sometimes command a premium. As a rule, the notes of such a bank are col-

[4]Bank act, section 65: (6) Nothing herein contained shall be construed to impose any liability upon the government of Canada, or upon the minister, beyond the amount available from time to time out of the circulation fund.

lected by the other banks and held until the date of redemption has been named by the minister of finance.

Management of Failed Banks

If a Canadian bank fails to meet any of its liabilities as they accrue, it forfeits at once its right of independent management and is taken charge of by a "curator" appointed by the Canadian Bankers' Association.

If the curator within ninety days is able to restore the solvency of the bank so that it is able to resume payments, it may resume business; otherwise the bank may be "wound up" and its charter revoked. During the first three months of a bank's suspension the stockholders have a chance to raise funds and restore the bank to solvency. If they fail, the curator then gives place to an official called a liquidator, who is appointed by the courts. Under a curator the stockholders still have hope and opportunity; under the liquidator the creditors of the bank are in the saddle.

The liquidator must first of all attend to the notes in circulation, their lien upon the assets being prior to all others. Inasmuch as the notes bear interest at five per cent from the date of suspension, the other banks are perfectly willing to hold them in their vaults until such a date as the liquidator names for their final redemption, all feeling certain that the notes will sooner or later be paid, for if the assets of the failed bank should prove inadequate, the mutual guaranty fund in the possession of the government will be drawn upon.

Next to the notes the deposits of the Dominion government have a prior lien, and then the deposits of provincial governments. If the assets of the bank are not sufficient to satisfy all the claims, the stockholders are liable to an assessment equal in amount to the amount of capital stock to which they subscribed plus any portion thereof which has not been paid up. Thus if a stockholder has subscribed for fifty shares of stock, par value $100, and has paid in only $2,500, he is liable to an assessment of $7,500, of which $2,500 is on account of the unpaid subscription and $5,000 is on account of the double liability.

Monthly Returns to the Government

The law provides for no publicity with regard to bank affairs beyond the returns to the minister of finance. The minister of

finance may call for supplementary information or "special returns from any bank whenever in his judgment they are necessary to afford a full and complete knowledge of its condition." The law, however, gives him no right of examination, and the government maintains no inspecting force.

Canadian Bankers' Association

The Canadian Bankers' Association is an incorporated body with powers and duties prescribed in an amendment to the bank act passed in 1900. Each chartered bank is represented in the membership and has one vote. The association is required by law to supervise the issue of bank notes and to report to the government all overissues, to look after the destruction of worn and mutilated notes, and to take charge of suspended banks. Its headquarters are in Montreal in the Bank of Montreal building, and its active executive officer is the secretary-treasurer. The expenses of the association are apportioned among the banks and do not apparently constitute a very heavy burden, for the secretary has an exceedingly small staff. All expenses incurred by the association on account of a suspended bank are, of course, a charge against the assets of the bank.

When the notes of a bank are so worn or mutilated that it wishes to replace them with new notes, notice is sent to the secretary of the association, a date is fixed, and in the presence of the secretary the old notes are duly counted and taken to a furnace, where they are consumed in the presence of the secretary and other witnesses. After this solemn operation has been performed and the signatures of all parties observing it have been duly attested, new notes are issued by the association to replace those that have been destroyed. The clearing houses in the Dominion are subject to regulation by the association.

C. The System in Time of Stress

Since the present system of banking was perfected in 1890, Canada has had no banking panic. She has suffered from periods of depression and hard times, caused either by short crops or by the failure of outside markets to absorb her produce at satisfactory prices, but never from scarcity of currency, from runs upon banks, from business failures, or from the inability of banks to meet their

obligations. It is impossible to escape the conclusion that the credit for Canada's immunity from panic and financial distress is mainly due to the character of her banking system.

No country can expect to be free from periods of dullness, no matter how perfect its banking system. International relations in trade and finance are so close that all countries suffer from the mistakes made by any one. Canada has depended very much upon English capital. She is relatively a large consumer of the products of the United States and has many an enterprise which owes its inception to American initiative. Hard times in England or in the United States must inevitably affect Canadian business. She is borrowing from England as this country did a century ago. Her credit system rests upon the gold reserves of London and New York. Under these circumstances, when one recalls how the credit and financial system of England and the United States have been shaken during the last twenty years, it is remarkable that Canada has escaped serious damage.

Strong Because Elastic

Canada's banking system contains two features that give it great strength under the threat of panic or crises. One is the elasticity of the note circulation, the other the solidarity or unity of the system. The reason why Canada has never suffered from a currency panic lies on the surface. The banks always have cash enough to meet the demands of their depositors. Instead of being in the position of their brethren across the border, that is, anxious to conserve their cash, they welcome any legitimate opportunity for the increase of their circulation. Except for a few weeks during the panic period of 1907, when practically all the banks of the United States had suspended cash payments, the Canadian banks have always had currency on hand in excess of their customers' needs. This currency consisted of their own notes. To their customers the bank notes are perfectly good money. Even though people got suspicious of the solvency of a Canadian bank, its notes would not be in disfavor.

Furthermore, when Canadian banks satisfy their customers' demands for cash, their resources are unimpaired. They are not obliged, as are the banks of the United States, to call loans in order to make good their cash reserve. With the public their notes

have all the efficiency of gold itself, and the fact that they are paid out so willingly by the bankers, the supply as a rule seeming inexhaustible, prevents anything like a panic starting among the people.

The elasticity of the note issue, however is not the most important factor contributing to the peace and security of the Canadian financial system. It must be regarded, indeed, as an essential factor, for without it the banks would be unable to maintain equilibrium without resorting to methods that at times would be perilous. If in any emergency they were obliged to raise their rates of interest and to seek to increase their resources by the reduction of loans, it is doubtful if Canada, despite the strength of its banking system in other respects, could escape from the losses caused by panic.

Solidarity or Unity of the System

The other feature making for financial ease in Canada, namely, the solidarity or unity of the banking system, is not easy to describe. It is a growth, a situation, rather than a creation of the law. When one has in view the protection of Canada's business and financial welfare; it is impossible not to regard the twenty-nine chartered banks, with their 2,200 branches, as a single institution. As lenders of money they are independent units. For that matter, the branch of each bank has a great deal of independence. All are independently seeking for deposits. Each branch is seeking to make the largest possible profit, and its manager is encouraging to the utmost the enterprises in his locality, for on the growth of the business he does depends his favor at headquarters. Nevertheless, from a national point of view, despite the competition among the banks and their branches, there is considerable reason for regarding the twenty-nine chartered banks of Canada as one institution.

Consider, for instance the following facts:

1. Over fifty per cent of the banking business in Canada is done by six banks. One of these, the Bank of Montreal, has assets exceeding twenty per cent of the total. Another, the Bank of Commerce, with head office at Toronto, has resources equal to thirteen per cent of the total.

2. The Bank of Montreal is the depositary of most of the government funds and among the people is commonly spoken of as the government bank.

3. The Bankers' Association, an organization created by law,

is a medium through which the best banking opinion finds authoritative expression. Through this association the banks keep advised of all pending legislation in any way affecting banking interests.

4. Bank managers are trained experts and each one has the expert's regard for a man who has had a wider experience or a better training than himself. As a result, no manager will venture far upon a policy which is regarded by his competitors as dangerous

5. All the banks are equally interested in the unbroken prosperity of the country. The managers of the six largest banks, each having charge of over a hundred branches are particularly watchful. They realize that speculative excesses in any part of the country will bring loss to them and must be discouraged.

6. On account of this mutual interdependence of the banks, no bank in Canada can hope to achieve success by striking out upon an absolutely independent policy, if such conduct is likely to meet with the disapproval of the banking fraternity. The business public, from which a new bank must get its support, has confidence in the management and judgment of the established institutions. A depositor may feel that he ought to get more than three per cent interest on his balance. He may complain that his bank does not give him credit enough, or that it is not liberal enough in its collections. Nevertheless he would be reluctant to give his account to a new institution or to any institution, whether old or new, if it were managed by men not in good standing with the leading bankers.

7. In their insistence on the rule that a man shall borrow from only one bank the banks have done more than appears on the surface to make their system a unit. If a merchant is refused credit at one bank, he finds it practically impossible to get help from any other. This rule certainly makes the twenty-nine banks of the Dominion, from the borrower's point of view, a single institution.

8 There is practical unanimity of opinion among bankers with regard to business conditions and the outlook. The managers of Canadian banks get their information with regard to the country's condition from the managers of branches. Since all know what is going on in every part of the country, it is not remarkable that all usually are very much in agreement for the sources of information of all are practically the same.[5] As a result, Canada has a "banker's

[5]During the writer's stay in Canada, in April, 1909, he talked with bankers in Montreal, Ottawa, Toronto, and Winnipeg. Everywhere he raised practically the same topics of conversation, and everywhere got practically the same answers.

opinion" with regard to the business situation, as distinguished from the "opinions of bankers" in the United States. In the latter country the bankers in the West are often in disagreement with the bankers in the East, and the eastern bankers are frequently in considerable ignorance of the conditions and events which are shaping the opinions of their western brethren. In Canada, with reference to questions of fact or actual conditions, one finds very seldom any difference of opinion among Canadian bankers. If there is excessive speculation in any part of the country, if a certain industry is suffering because of tariff changes in Europe, or because of a scarcity of raw materials, or if capital is being employed in an industry in amounts not warranted by the demand, or if there is the prospect of a light yield of any agricultural product, the bankers are among the first to get the information, and all of them have it.

Importance of the Banker

This unanimity among the bankers with regard to business conditions makes the individual banker a much more important person in Canada than he is in the United States. Business men there do not speak of him as a mere money lender. They look upon him as a man who has especial facilities for getting information about business and financial questions and whose opinion, therefore, is entitled to great respect. This is true not only of the general managers, who as a rule live in the large cities and are men past middle life, but is true as well of the managers even of the small branches. In every community the manager of a branch bank, especially if it is a branch of one of the half dozen largest institutions, occupies a prominent position and exerts a powerful influence in the shaping of business opinion. Not only does he send reports daily or weekly with respect to events of importance within his field, but he himself is constantly getting letters of advice from the head office. He is the one man in the community who is in touch with the business conditions of the Dominion or, for that matter, of the world. He may be a young man, but he has had a training in the methods of Canadian banking, and it is known that he would not

The managers at the head offices get daily reports and letters from their branch managers, and the head offices in their turn send out information to the branches. As a result the men in the banking business in Canada know more about the whole country than any other set of men. The files of one of the larger banks probably contain more valuable and more accurate information about the current events in Canada than can be found in the files of any newspaper.

occupy his position if his superiors did not have confidence in his judgment.

As a result of all these conditions working together, it may fairly be said that Canada possesses many of the advantages of a central bank. The employees of each bank, from general manager down to the office boy in the smallest branch, are busily occupied in doing their share toward increasing the bank's business and profits. Each is keenly on the lookout for an opportunity to establish a new branch in a promising young community, and each is doing its best to serve its customers and to gain new ones. But if a cloud appears on the horizon, if bad news comes from England with regard to Canadian investments, or if there is wild speculation in Wall street, the leading bankers get together, not formally, but informally, and as a result the Canadian banks become practically a unit in their attitude toward the common peril.

The Panic of 1907

The policy adopted by the Canadian banks at the end of 1906, and followed throughout the strenuous year of 1907, illustrates forcibly the solidarity of the banking system. All business men remember the feverish activity of 1906, the steady advance in prices of goods, the insatiable demand for money, and the high rates of interest everywhere prevailing at the end of the year. To the average man it seemed a period of boundless and unending prosperity. Railroads had not cars enough to haul the freight offered them and could not get them built fast enough. Manufacturers in the United States and in Canada had withdrawn their traveling salesmen because they already had orders for a year ahead.

In the United States a few of the leaders in industry and finance sounded a note of warning, but most men were too busy to hear it and most of the 10,000 bankers refused to believe it justified. As the decline in the market prices of securities began in January, a few bankers in New York City—those in closest touch with the financial needs of corporations and with the temper of foreign money markets—became convinced that serious times were ahead. Most of those men, knowing that a public expression of their apprehensions would do little good and might do harm, silently went about the business of strengthening their resources. Meantime 10,000 or more bankers throughout the country, wondering

why the stock market should be weak when the country was so prosperous, continued to make advances at high rates of interest to expanding enterprises. As a result, when the crash came in October, it is doubtful if more than ten per cent of the bankers in the United States were prepared for it, and for several weeks there was an almost universal suspension of specie payments and withdrawal of banking support from deserving borrowers.

Canadian Banks Were Prepared

In Canada there was no panic. For a year the leading Canadian bankers had been urging upon their customers the necessity for caution, and in their annual reports to the shareholders early in 1907 bank presidents and general managers had given notice that the phenomenal profits and business of the preceding few years could not be expected to continue much longer. Financial journals and editorial writers for the daily press, taking their cue from the bankers, had for months called attention to the strain upon the world's money markets and pointed out the necessity for conservatism, not only among the banks but among the promoters of new enterprises.

In January, 1907, there was only one opinion among bankers as to the financial situation. For several years the country's trade had been expanding by leaps and bounds. Immigrants had poured into the country from Europe and from the United States. New capital had come from England and the United States at the rate of $200,000,000 a year. The profits of industrial and commercial products had been large. In ten years bank loans and deposits had doubled. In short, Canada's prosperity had been even greater than that of the United States. The demand for capital had outrun the supply, and the strain upon the banking resources every bank manager knew had reached the danger point. Every one of them said this to their shareholders; the newspapers published their remarks, and business men throughout the Dominion knew not only that they ought to retrench, but that they must. They knew that they could get no help from the banks if they sought to enlarge their operations.

Gradual Contraction of Loans

It was impossible, of course, for the banks to call an immediate halt in the expansion of enterprise or in the use of their credit.

During 1906 the current loans in Canada had risen from $450,000,000 to $550,000,000, an increase of nearly twenty-five per cent. Any attempt on the part of the banks to bring this upward movement to a sudden termination would have ruined many a solvent concern. For five months, or until the end of May, the banks suffered it to continue, their loans during that period rising from $550,000,000 to $590,000,000. Then began a gradual contraction and a steady increase in the cash reserve. Between June 1 and September 1 the total of their current loans in Canada declined $10,000,000. At the same time they strengthened their reserves by accumulating cash in their own vaults and by enlarging the amount of their funds on call in New York City. Canadian borrowers were treated with more consideration than those in foreign countries, as is shown by the reduction in current loans elsewhere from $36,000,000 to $23,000,000 between February 1 and July 1. The banks appear to have endeavored to convert their time loans outside of Canada into call loans, having in view an increase in the amount of funds available for immediate use.

Between January 1 and September 1 there was a decline in the demand deposits from $192,000,000 to $160,000,000 and an increase in time deposits from $400,000,000 to $425,000,000, so that the total of deposits suffered very little diminution. After the first of September, however, deposits steadily declined until the end of the year; time deposits from $425,000,000 September 1 to $400,000,000 December 31. Demand deposits remained practically unchanged during this period.

By the first of September Canadian bank managers were evidently quite alive to the necessity for caution. Thereafter all the changes in their statements indicated a conviction on their part that the situation was precarious and that the banker's first duty is to preserve the solvency of his bank and take care of its regular customers. They knew that large sums would be demanded of them for the movement of the crops and were disposed therefore to take every precaution against weakness. The season was late and it was known therefore that there would be difficulty getting the crops to market, for the Canadian railroads, like those in the United States, were embarrassed by lack of equipment.

Call Loans Reduced in New York

When the crash came in New York and the Knickerbocker Trust Company suspended on the 22d of October, Canadian banks immediately adopted measures of self-protection. During the next two months the total of their call loans outside of Canada declined from $62,000,000 to $40,000,000. There was also a small reduction of their call loans in Canada. Their cash reserve was increased by $5,000,000. Their current loans in Canada, however, were $10,000,000 less November 30 than on October 1, and in December they fell off $15,000,000 more. These two months, November and December, were strenuous months in Canada as they were everywhere in the world. The western wheat crop was late and as a result there was a great clamor for funds for their movement. Currency was so scarce in the United States that Canadian bank notes disappeared over the border and performed their function as a medium of exchange in towns and country districts in the United States many miles distant from the Canadian line. Most of the banks found that their circulation was dangerously near the maximum and feared that they might be called upon to pay out legal tender. There was not the slightest suspicion of banks in Canada and no talk whatever of a run upon any bank. People did complain, however, that the banks were not doing their duty by the western farmers. Why should the banks be lending money on call in Wall street, when the farmers of Manitoba were unable to market their crops because buyers could not get funds from the banks?

Circulation Too Near The Limit

The banks, their deposits declining, their circulation near the maximum, the railroads unable to haul the crops promptly to market, dared not tie up funds in agricultural products which might later be called for by the commercial and industrial interests of the Dominion. If their capital had been larger so that they might have expanded their note circulation with impunity, the situation would have been less difficult. Yet something more than notes was wanted. For the first time in many years Canada felt the pinch of that want which is annually felt in the United States, namely, a sudden and great increase in the demand for both capital and currency. And for the first time they faced the risk of being

compelled to pay out legal tender money if they satisfied the demands of grain buyers. In other words, the Canadian banks and the agricultural interests of Canada during the last three months of 1907 had a taste of what the banks and farmers of the United States experience every year. The banks dared not make large advances to the buyers of grain lest the depletion of their reserves or an excessive issue of notes should result. The total circulation had climbed up to $89,000,000, which was only about $6,000,000 under the maximum, and no bank felt that it could authorize its branches to increase the issue of notes; the risk of being called upon to pay the penalty for excessive issue was too great.

To the Canadian banker and to his customer the situation was entirely new. Never before during this generation had the banks been obliged to restrict their loans merely because they feared that an excessive issue of notes might result. Serious and new as the situation was, and though it gave rise to many complaints in business circles, nevertheless there were no important business failures in Canada, and bankers in general felt confident that they would be able to bring the country safely through the crisis. In the last two months of the year the deposits declined $30,000,000 and the current loans in Canada $25,000,000. This shrinkage was inevitable. Many depositors having investments in the United States were obliged to protect them by the withdrawal of funds from Canada. The banks, on their side, were obliged to withdraw their assistance from such customers as needed it least. It is the boast of the banks, however, and is now generally admitted, that during these two months no man who actually deserved and needed a loan was refused it, and few borrowers were obliged to pay an unusual rate of interest.

The Government Tries to Help

Canadians are readers of the newspapers of the United States, and they know something about our habit of calling upon the government for aid whenever money is "tight." So the question was asked, Why should not the Dominion treasury come to our relief? The banks, it should be noted, did not ask this question. They did not believe that government aid was necessary. Nor was it evident how government aid could be afforded, for the Dominion treasury, unlike that of the United States, keeps all of its cash at

all times in the banks, and so has no reserve fund on hand on which to draw for the purpose of easing the money market. The government, however, was impressed by the popular demand and came forward with an offer of relief which involved a suspension of the Dominion legal tender act, similar to the suspension of the Peel bank act whereby the Bank of England has been permitted to issue notes unsecured by coin.

The issue was made upon the authority of the governor in council dated November 12, 1907, on a memorandum from the minister of finance, in which he described the effect of the world-wide monetary stringency upon Canada and declared that there was much anxiety in the West among farmers, traders, and bankers over "the prospect of insufficient financial accommodation to move the crop." He recommended that the minister be authorized to issue new Dominion notes and deposit them with the banks most largely interested in the grain business, and to accept from the banks high-class securities. In the second memorandum, dated November 26, he recommended that the advances be made through the Bank of Montreal, at such rates of interest, not less than four per cent per annum, as the Bank of Montreal might deem fair and reasonable. The advances were not to exceed $10,000,000 and were to be protected by the deposit of securities satisfactory to the Bank of Montreal. These issues of Dominion notes were approved by act of Parliament July 20, 1908. Events proved that the bankers were right in their claim that they were fully able to take care of the western situation, for there was a call for only $5,115,000 of this emergency issue of Dominion notes. The bankers understood the situation better than did the minister of finance.

The character of the year 1908 is shown by the bank returns. Current loans declined steadily from November 1, 1907, until March 1, 1909. Deposits, however, began to increase early in 1908, time deposits rising from $395,000,000, March 1, to $430,000,000, December 31. In the same period demand deposits increased from $140,000,000 to $210,000,000, while the cash reserve moved up from $75,000,000 to $100,000,000. The banks being unable to employ their idle funds in Canada during this year, put them out on call in the New York market. The item "call loans elsewhere" rose from $41,000,000, December 1, 1907, to $106,000,000, December 31, 1908, and by the end of May, 1909, had climbed to $125,000,000. This

is a much larger sum of money than the Canadian banks care to employ in the call-loan market.

During 1907 the banks gradually reduced the amount of call loans in Canada by about $11,000,000. The funds thus released were loaned to merchants, manufacturers, and the buyers of grain. In 1908 this item began to increase, the banks having more money than was needed by business interests. They adopted the same policy with current loans outside of Canada, reducing these during 1907 from $36,000,000 to $23,000,000. In 1908 this item began to increase.

Early in the year, 1907, in anticipation of a strain, the chartered banks began to increase the cash reserve, at the same time calling loans in New York and reducing foreign balances. Between May and October they loaned rather freely in the New York call-money market, but during October and November they reduced their outside call loans by $20,000,000. Their credit balances and call loans outside of Canada both increased greatly in the first seven months of 1908, when the demand for money was small in Canada. In the last quarter of 1908 the decline in foreign credit balances explains the rapid increase in outside call loans. Throughout 1909 the banks had resources beyond the needs of Canada, and the outside call loans rose to $138,000,000, an increase of nearly $100,000,000 in two years. In the same two years the cash reserve rose from $80,000,000 to $105,000,000, and the amount of securities held from $71,000,000 to $86,000,000. It is interesting to note that the amount of securities varied but little during 1907. It was not a good year for bonds.

Two Interesting Bank Failures

The story of banking is not without its dramatic incidents in any country. Canada has probably had fewer such incidents in the last generation than most countries, yet there was a bank failure in 1906 which furnished unique details. On the evening of October 12, the bankers of Toronto and Montreal heard with surprise that the Bank of Ontario had gone beyond its depth and would not open its doors the next morning. Its capital was $1,500,000 and its deposits $12,000,000. The leading bankers in the Dominion dreaded the effect which the failure of such a bank might have. The Bank of Montreal agreed to take over the assets and pay all the

liabilities, provided a number of other banks would agree to share with it any losses. Its offer was accepted and a representative of the Bank of Montreal took the night train for Toronto. Going breakfastless to the office of the Bank of Ontario he found the directors at the end of an all-night session and laid before them resolutions officially transferring the business and accounts of the bank to the Bank of Montreal. They adopted the resolution before nine a. m. and the bank opened business for the day with the following notice over its door: "This is the Bank of Montreal."

Before one o'clock the same notice, painted on a board or penciled on brown wrapping paper, was over the door of the thirty-one branches in different parts of the Dominion. Its customers were astonished that day when they went to the bank, but none of them took alarm and many of them were well pleased with the change. The note holders and depositors were paid in full, and it is generally understood that the venture was a profitable one for the Bank of Montreal, although litigation is still pending over the double liability of the stockholders. The general manager of the Bank of Ontario, who had sunk its capital in Wall street, received a five years' sentence for making false statements with regard to the bank's affairs.

First Outbreak of High Finance

Only one other large bank has been in trouble since 1890. It was the Sovereign Bank, an institution having over eighty branches and $16,000,000 in deposits. It was established in 1903 and was managed by an artist in "high finance," the only one of that class, it is claimed, who ever controlled a big Canadian bank. It is claimed that he was backed by large financial houses in New York and in Germany. He was reckless both in spending and in lending money, and early in 1907, when the assets amounted to over $25,000,000, it became known that much of its paper was valueless. The capital stock was reduced and a new management was placed in charge, but in January, 1908, the bankers of Toronto and Montreal were informed that the Sovereign would be obliged to suspend unless it received assistance. On the 18th of January its business was taken over by twelve banks which guaranteed the creditors against loss. The branches of the bank were divided among these twelve institutions, and report has it that some of the general managers were for a time unable to find all the branches that had been allotted to

them. The manager of the Sovereign, in his search for communities needing branch banks, had gone ahead of both map makers and the post office department. The assets of the bank are not proving equal to the liabilities, but the guaranteeing banks are protected from loss by the double liability of the stockholders.

The circumstances attending the liquidation of these two large banks certainly strengthen the view advanced in this chapter with regard to the solidarity or unity of the Canadian system. Bankers still shake their heads ruefully over the havoc wrought by the Sovereign and over the changes it made in banking practices, whereby various minor profits were annihilated, and declare that if another specialist in "high finance" appears among them they will let him and his friends take their medicine. "The banks can not go on forever," they say, "standing between the people and a rotten bank." Like the directors of the Bank of England, the presidents and managers of the big banks in Canada deny that any responsibility rests upon them for the protection of the country's financial security, yet when the next pinch comes the situation itself will compel them in self-defense to act together both quickly and effectively.

Since 1889 six small banks have failed, but note holders have lost nothing and depositors very little. They were local institutions with few branches and their failures possess little significance in a study of the banking system as a whole.

Conclusion

The Canadian banking system possesses features of extraordinary merit, adapting it admirably to the needs of the country which it serves. It performs most efficiently the service for which banks are created, gathering up the country's idle capital and placing it in channels of useful employment. The assets of the banks are of high quality because of protection afforded by the law and because borrowers are prevented by custom from hawking their paper through brokers. The law leaves the banks such freedom in the use of their credit that business is never brought to a halt through lack of instruments of exchange; whether the need be for checks and drafts or for bank notes, the supply is always adequate. The redemption system insures perfect elasticity for both the note and deposit currency. The reserve seems to be abundant for the

protection of the liabilities and to be composed of elements sufficiently liquid and available. Finally, on account of the extent to which the larger banks are interested in the trade and industries of all parts of the Dominion because of the investments made through their branches, the system possesses a solidarity that makes possible united action in the face of a common peril.

THE STOCK EXCHANGE AND THE MONEY MARKET

By Horace White,
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The relations of the stock exchange and the money market to each other are primarily those of the promoter and the investor, and secondarily those of the borrower and the lender.

The distinction between money and capital should first be noted. Capital consists of all the goods in the world that are subject to sale and transfer. Money is an instrument of exchange, the possession of which gives the owner command of capital at the prices prevailing at any given time. The supply of capital is, in the nature of things, limited. Both the production and the consumption of capital go on at all times. The excess of production over consumption forms new capital available for the creation of additional means of production, from which income may be derived. The owners of this excess may themselves apply it to this purpose, or transfer it to others. Ordinarily an easy money market means that the demand for capital is not in excess of the supply. Conversely a tight money market means that the demand has overtaken the supply and that men are bidding against each other for the possession of it; the competition of bidders causes general prices and the rate of interest to rise.

The function of the stock exchange as a promoter of new enterprises consists of its great clientage of buyers, of its facilities for advertising securities, and of its reputation for carefulness in scrutinizing applications for admission to its list. Its buyers are practically innumerable in both hemispheres. Its quotations are published free of cost in nearly all daily newspapers. No enterprise is admitted to its trading list without previous examination by a committee of experts. While the exchange does not guarantee the goodness of any security, or even the truthfulness of the statements filed by its managers, it requires the filing of such statements prior to admission, and at stated intervals thereafter, and it inflicts summary punishment for any breach of good faith therein. Thus, the fact of

admission to the list becomes prima facie, although not conclusive, evidence of the character of the investment.

The money market consists of all the loanable funds in the country. The money which people are using in their daily business, which passes from hand to hand in retail trade, is no part of the money market. Such money is not marketable because it cannot be recalled from the immediate service which it is rendering to society. The bulk of loanable funds of the country consists of bank credits which are bottomed on gold; and the magnitude of such credits is limited by the amount of "lawful money" held by the banks as reserves. Bank notes are not available as reserves of national banks, although they are such for state banks and trust companies. This is a slovenly and dangerous practice which ought to be corrected by the clearing houses of the country, if the state laws allow it to continue. Any attempt, however, to enlarge the loanable funds of the banks by "taking out" bank notes not needed for hand to hand circulation, would be defeated by their prompt return for redemption in lawful money.

A certain amount of loanable funds is always held by private persons, but since they usually keep their money deposited in banks the portion which they draw out lessens the amount which the banks can use in the loan market. The lending power of these institutions in the aggregate may be many times greater than the amount of the lawful money in their vaults, since ninety per cent or more of the trading which takes place in our large cities is done by means of bank credit and clearing house transactions.

The most common function of banks is the discount of commercial paper running for short periods of time and representing actual transfers of property in the business world. In this way the bank exchanges its well known credit for the less known credit of merchants and manufacturers. An ideal condition for a bank is one wherein the supply of good bills is sufficient to absorb all of its loanable credit and where the inflow of cash from maturing ones is equal to the outgo of new ones. There is always some difference, however, in the character and quality of bills offered for discount, and when the amount of acceptable paper is less than the amount of the bank's loanable funds, advances may be made on goods or securities that are readily salable in the market. In this way interest is earned on money that would otherwise remain idle. In

the event that securities of this character are not available at home the banker may place his surplus funds as deposits payable on demand in some other place where such securities are bought and sold. Usually a low rate of interest, say two per cent, is allowed on such deposits.

The piling up of these deposits in the banks of New York lowers the rate of interest on call money and incites speculation. If Union Pacific, for example, pays dividends of ten per cent and is selling at 170 or under, it yields 5.6 per cent on the purchase price. If the purchaser can borrow money on call at one and one-half per cent, as is the case now, he gains a profit of three and one-half to four per cent as long as such conditions continue. Speculation thus started may run a considerable time and draw in a large number of participants and extend sympathetically to the whole list. Speculators may bid up the price of stocks, and the rate of interest at the same time, until a climax is reached. Then a reaction will come, stocks will fall, margins will be exhausted, speculators will be sold out, banks may fail, liquidation will pursue its inexorable course, and a *tabula rasa* will be made, upon which a new cycle of inflation and collapse may take its start.

The essential difference between the two methods of employing a bank's resources is that discounted bills are always bringing in the means of payment of the banker's liabilities, while loans on collateral, whether payable on call or at a fixed time, depend on the sale of the securities, the selling of which may be restricted, or prevented altogether, by the lack of buyers in the market. This is an important difference. In Germany the Reichsbank is not allowed to *issue circulating notes* against collaterals, not even government bonds, while it may issue them to any extent against one-third cash and two-thirds bills discounted having not more than three months to run. Moreover, a higher rate of interest is charged on collateral securities than on bills. The aggregate amount of loans on collateral in the Reichsbank does not usually exceed fifteen per cent of the whole. An explanation of this practice is given by Dr. Koch, former president of the Reichsbank, in a paper reprinted among the documents of our National Monetary Commission, as follows:

> For a bank of issue, the aggregate of whose investments must always be on a level with that of its obligations, it is not merely a question of safety, but fundamentally of the liquidity of the investments. No person who has any

acquaintance with such matters will believe that loans on securities can be compared with discounts, represented by bills carefully chosen according to sound principles of banking, with respect to the possibility of quick realization. Loans on securities are always lacking in the quality of transparency, it being often not easy to see what is behind them. They do not rest in all cases on a basis of substantial business dealings like commercial bills, and in particular bills drawn against the delivery of merchandise, which always presupposes the existence of the equivalent in commodities, or as the net proceeds of a sale. In general there are no indications as to how the credit sought is going to be used, while the probability of punctual payment depends upon just this factor. It is thus possible that the bank may be compelled in time of crisis, when its own customers are falling into arrears, to proceed to realize on securities in great quantities in order to protect its 2,000,000,000 marks, or more, of demand liabilities. There are times when it is impossible to realize on them, or at least not practicible without great losses.

The Reichsbank, although owned by private persons, is administered by the state. The profits of the shareholders are not the first consideration of the management. The public advantage takes precedence, and this is found to be best served by limiting advances on collaterals as aforesaid.

The stock exchange is a meeting place of the buyers and sellers of invested capital; that is, of incomes present or prospective. This is a comparatively modern institution because invested capital transferable by negotiable instruments is of modern origin. There were exchanges in the ancient world where traders met to deal in various kinds of movable goods. The Agora of Greece, and the Forum of Rome, and the Fairs of the Middle Ages were such exchanges, but negotiable incomes (stocks and bonds) did not then exist. At the present time no person of intelligence keeps surplus money uninvested. He buys some interest-bearing security, or puts it in a savings bank, in which case the savings bank buys an interest-bearing security, or employs it in such manner as to yield an income.

Capital is the result of saving. If not the parent of civilization, it is the indispensable promoter and handmaid of it, since capital gives mankind the leisure and the means to take new steps forward in solving the problems of human existence. It is desirable that there should be facilities for investing the savings of the people without serious delay. Such facilities promote saving. It is desirable also that investments should be reconvertible into cash without delay. The *raison d'être* of a stock exchange is to supply a place where money can be invested quickly, and recovered quickly, or

upon which the investor can borrow money immediately if he so desires. It is an incidental advantage that the stock exchange informs all investors, and intending investors, daily and without cost to themselves, of the prices at which they can buy or sell the securities on the active list of the exchange. These prices are made by the competition of buyers and sellers in the market, who are acting under the spur of self-interest. There is no other way in which true prices can be made. If the quotations so made are not precisely the truth in every case, they are the nearest approach to it that mankind has yet discovered.

The gross amount of negotiable securities admitted to the New York Stock Exchange is upwards of twenty-five billions of dollars, as shown in the following table as of the date of June 6, 1910:

Railroad bonds	$7,181,949,250
Railroad stocks	7,205,766,185
Industrial bonds	632,446,350
Industrial stocks	3,011,885,300
Street railway bonds	633,206,000
Street railway stocks	475,659,900
Telegraph and telephone bonds	245,400,200
Telegraph and telephone stocks	530,994,700
Gas and electric light bonds	201,537,000
Gas and electric light stocks	267,366,000
Coal and iron bonds	84,810,500
Coal and iron stocks	140,781,800
Mining stocks	347,052,000
Miscellaneous stocks	233,532,700
Miscellaneous bonds	249,257,000
Banks and trust companies	134,592,800
Express companies	68,967,300
U. S. Government bonds	847,891,230
Foreign government bonds	2,293,859,300
State government bonds	85,403,943
New York City bonds	422,614,600
Other city bonds	19,455,000
	$25,314,429,058

The sales of securities on the exchange during the calendar year 1909 were upwards of twenty billions of dollars cash value. Such figures are like the distances of the fixed stars; the human mind fails to grasp them. They do not, however, tell the whole

story, for there are two other exchanges in New York which deal in negotiable securities and there are stock exchanges in Boston, Philadelphia, Pittsburgh, Chicago, San Francisco, Montreal and several other cities, which are accessible to investors and speculators on this continent.

Under the rules of the New York Stock Exchange every trade made on the floor must be settled and completed within twenty-four hours, unless otherwise specified; *i. e.*, the seller must deliver the thing sold, and the buyers must pay for it in full, at or before 2.15 p. m. of the day following the transaction. All but an insignificant part of the trading on the exchange is of this kind. If all the purchasers should pay in full with their own money there would be no resort to loanable funds. But probably nine-tenths of the transactions are speculative. In such cases a portion of the money, say ten or twenty per cent, is supplied by the buyer, and an equal sum by the broker who makes the purchase, and the latter borrows the remainder from a bank, giving the stock or bonds so bought as security for the loan. The amount advanced by the purchaser is called the margin, and there is always an agreement, express or implied, that the margin shall be kept good in case the market price of the securities declines. If the purchaser fails to respond when called upon for more margin, the broker may sell him out. The bank exercises the same privilege as against the broker. The bank may call upon the broker at any time and without assigning any reason. The percentage of the margin that may be required is a matter of bargain between the parties. If a stock is very active, *i. e.*, if there is always a large number of people trading in it, the variations, although frequent, are likely to be small, hence a small margin will suffice. If, however, the security is seldom bought or sold, a large margin is required, because a quantity may be offered suddenly to be sold for what it will bring, and there may be no bid for it at or near its customary quotation.

The making of bank loans to stock brokers is bottomed primarily on the confidence which the banker has in the broker as a person, and secondarily on the goodness of the securities offered. The *modus operandi* is substantially this: The broker, knowing from his clearing sheet of yesterday what payments he has to meet to-day, obtains from his bank in the morning authority to draw for this aggregate amount at an agreed rate of interest. As his

checks come in during the day the bank certifies them and the broker sends to the bank securities whose market value is greater by a certain margin than the amount borrowed.

These loans are usually payable on call. As national banks are forbidden by law to certify checks for a sum greater than the drawer of the checks has on deposit, the practice in such cases is for the broker to execute a promissory note, which note the banker discounts, putting the proceeds to the credit of the broker, and attaching the security to it as it comes in during the day. While this method exposes the banker to some danger of loss in the interval between the certification of checks and the receipt of the securities, such losses seldom occur. There is an unwritten rule of the stock exchange that the bank must be protected at all hazards, both as a matter of personal honor and because the stock brokerage business cannot be carried on otherwise.

But it happens sometimes that the broker himself is suddenly disabled. Such a case happened in the Columbus and Hocking Coal and Iron speculation a few months ago. Here the broker was confronted with a precipitate fall of fifty or sixty points in a stock that he and others were "manipulating," or at all events supporting, by purchases on the exchange. Three banks that had loaned their credit to him in the customary way sent hastily to the broker's office to demand security. The one whose messenger arrived first took all that the debtor could lay his hands on, but the amount was not sufficient. The others got nothing. The brokerage firm went into the hands of a receiver in bankruptcy, and the receiver made a demand upon the bank which had been so alert in collecting its claim, to surrender, as assets of the bankrupt estate, the securities so obtained. The national law forbids the giving of a preference to any creditor in case of impending failure: and thereby hangs a lawsuit which is still pending, and which may lead to radical changes in the business methods of the stock exchange and the money market. Doubtless the case will be carried to the highest court since it involves the question whether stock exchange securities pass by delivery in cases where bankruptcy is apprehended, and also what facts justify the presumption of approaching bankruptcy.

However these questions may be decided, the Columbus and Hocking example shows that it is not safe for bankers to rely upon the quotations of the ticker alone to assure them of the goodness

of stock exchange securities. If these can drop suddenly fifty points, no lenders on collateral are safe. They must have better knowledge of the character of the security they accept than the figures which the borrowers themselves may cause by bidding up prices. The ticker is not an infallible guide, nor is it the only guide which the stock exchange supplies. It requires all companies admitted to the stock list to file reports of their financial condition from time to time. If lenders do not avail themselves of this information, or if they misinterpret it, they have only themselves to blame.

The relations of the stock exchange and the money market are those of borrower and lender, but they are by no means as simple as they seem. The twain are gigantic bodies which act and react upon each other like planets revolving around a common center. It is a problem of great complexity to find the causes of the conditions prevailing at any time. Still more difficult is it to predict what conditions may prevail six months hence.

The state of the money market at the present time (August, 1910) aptly illustrates the complexity of the problem. The rate of interest for call money on stock collaterals is between one and two per cent—a very low rate. On short-term notes of good corporations, however, it is from five to six per cent, while first-class dividend-paying stocks can be bought at prices which yield the investor six to seven per cent. Money is flowing to New York from the interior, and the city banks are paying two per cent interest for country bank deposits. The surplus reserve of the city banks is upwards of fifty million dollars, the ratio of reserve to deposits being much above the legal requirement. Under such conditions a visitor from Mars would infer that money was very easy, but it is not so. The fact that it is otherwise is proved by the recent importation of gold from Europe, and also by the sudden movement of bankers to prepare for using the note-issuing privileges of the Aldrich-Vreeland act, which they have neglected during the past two years. In fact, money is tight for everybody except stock speculators. The explanation of the phenomenon is that the present is a period of distrust. The men who control the loanable funds of this country and of Europe as well, are not willing to let it go out of their hands except for short periods. Money is loaned at very low rates on call because it can be recovered quickly.

But how, it may be asked, can our city banks pay two per cent

for country deposits and lend the same money at one and one-half per cent? The answer is that it is sometimes better to lose half of one per cent than to lose a customer. Moreover, the city bank does not make all of its stock exchange loans at call. It makes some for fixed periods at rates varying from three per cent upwards, according to the time they run and the character of the borrower and his securities.

Periods of confidence and periods of depression come and go in undulations. The business world has had its ups and downs, not exactly with regularity but with something approaching it, during the past three centuries. The essential factor and prime cause of a commercial crisis is speculation leading to inflated prices and the piling up of debts based upon such inflation, which the debtors cannot pay. We had such a crisis—one of the first magnitude—in 1907. There is no evidence that the crisis was due in any special manner to stock speculation. Doubtless stock trading ran *pari passu* with other trading—it generally does. The inflation which prevailed generally did not avoid the precincts of the stock exchange, but that institution was not a sinner above others in bringing down punishment. It was the most conspicuous sufferer, however. More columns in the newspapers were given to it, more eyes were turned upon it, than upon any other. So when the rate of interest in the "loan crowd" went up momentarily to 125, there was a shock in the financial world. But the plight of the man who paid 125 per cent over night or for a few days, in order to avoid a greater loss, was not so bad as that of the merchant or manufacturer, who could not get his paper discounted at all. The benevolent usury law prevented him from paying more than six per cent and there was no money to be had at that rate on a commercial basis—none except as a matter of favor.

Banks find it for their interest to take care of their regular customers in times of panic, but they have the right to discriminate, and they exercise it. The temptation of 125, or even twenty-five, per cent is not easily resisted. Here the stock exchange exercises an influence on the money market. It can draw money from the banks that ought to be at the service of productive industry. Even banks which have no stock brokerage business of their own, sometimes turn money into the vaults of trust companies in order to reap the profit of high rates on the exchange. But this signifies

merely that water will seek its level, and that money tends to go to places where the highest reward is offered for it. This is the reason why city banks allow interest at two per cent on the balances of country banks subject to check. There is a borrower at hand who can usually pay more than two per cent for call money. The country banks must keep some balance in the city banks for the convenience of their customers. They are allowed to keep three-fifths of their legal reserve in a city bank. The law lends its influence to this extent to the piling up of money for the use of stock speculators. This system is sometimes fraught with danger, and the question has been under debate for half a century whether the payment of interest on deposits ought to be allowed at all.

How to prevent it is a question perhaps even more difficult of solution. If national banks were forbidden to pay interest on deposits, the prohibition would not extend to the state banks, trust companies and private bankers. These would pay interest for the surplus funds of the country banks; and the national banks would thus be at a disadvantage. If the country banks in the national system were not allowed to keep three-fifths of their reserves in the city banks, they would compete at a disadvantage with the state banks in their own localities. Thus the advocates of prohibition of interest on deposits always come to an *impasse,* and the old system continues. It continues because "there is money in it." It has an economic basis. I see no reason why the country banker should not make the most profitable use of the surplus funds in his charge. Self-interest prompts him to take care of his own customers first. If he does not do so, they will soon leave him. After he has done that he may properly place his surplus in a city bank of good repute and receive interest for the same. The fact that there may be a general crisis, say once in every ten years, and a spasmodic grab for bank deposits, is a problem by itself, which may be open to more than one solution. Any arrangement which should quiet the fears that lead to the grabbing of deposits would effect a cure of this disorder. This end is secured in most European countries by means of a central bank of issue.

In conclusion it may be said that the relations of the stock exchange to the money market as a borrower are of the same nature as those of the produce exchange and of the cotton exchange. The only difference is in the magnitude of the transactions. The stock

exchange is so large, its borrowings at times so colossal, that they affect the money supply of the world and are capable of absorbing the last dollar that can be tempted from the vaults of banks or the pockets of individuals in both hemispheres. This absorption may take place by the rise of prices of the securities traded in, or by the quantity offered, or both. Usually the demand for money is most imperative when the prices are highest and the quantities greatest. The question whether this condition is an evil, is in effect the same as asking whether speculation is an evil. Upon this point Governor Hughes's committee on speculation in securities and commodities last year, reached the conclusion that to some persons it is an evil, and to others not, and that there is no way to prevent it, without putting an end to trading altogether. In that view the writer concurs. It should be added that speculation has a steadying effect on the market prices of both securities and commodities. To banish it would be to banish nine-tenths of the business, in which event the fluctuations in prices would be much greater, and the work of the manipulator more facile and dangerous, than now.

THE INDEPENDENT TREASURY AND THE BANKS

By Murray Shipley Wildman,
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The relations which exist between our federal treasury and our banking system are in several respects unique. Our practice has been determined by political rather than commercial and financial exigencies, and in response to popular opinion molded by a vague dread of a money power. Strange to say, this public sentiment, so jealous of the safety and purity of the federal treasury administration, has not developed a consistently similar organization for any of our states or municipalities, nor can one find a precedent anywhere in modern Europe.

The normal relation between a public treasury and a bank or group of banks is exactly like the relation between any private firm or corporation and its banker. Such relation may be regarded normal since it persists throughout the United States with respect to the public funds of states and local organizations and throughout Europe with respect to national as well as local funds. Normally the bank is regarded as a place for deposit of revenue, and from it disbursements are made by check or draft. The deposited funds pass to the legal ownership of the bank and are used in any manner consistent with the prevailing rules and customs of banking, and the public usually holds in return the rights of a depositor and no more. With respect to the lending function of a bank the same analogy holds true. The properly authorized officials of the treasury may borrow in anticipation of revenue and pay interest proportioned to the nature of the loan, the character of the security and the state of the money market. The proceeds of the loan appear as a deposit subject to check and there is essentially no other effect upon the banker's assets, liabilities, reserves or lending power than would be felt in the event of similar transactions with a private corporation of equal magnitude.

For nearly three-quarters of a century the attitude of our gov-

ernment toward the banks has been one of distrust, and in the later decades this distrust has been associated with a peculiar paternalism. Not only are the banks regarded as incompetent to take care of the government business, but in a large sense they are regarded as unfit to attend to their own business, and they have been subjected to a system of regulation, both state and national, which grows more and more minute as the years pass. With this great mass of regulative law we are not concerned except where it involves the specific relation between the federal treasury and the banks. The significance of this suspicious and paternal attitude of the national government may develop in a discussion of the following propositions: First, the position of the treasury as contemplated in law and tradition is one of complete isolation. Second, the rigidity of this situation is in a measure relaxed by the practice of lending treasury funds to certain banks on collateral security. Third, the treasury undertakes to guarantee to a limited extent the current liabilities of national banks which own and are willing to hypothecate a special class of assets.

I. The Isolation of Treasury Funds

It would be superfluous to review the history of the independent treasury further than to remind the reader that it is an inheritance from the Jacksonian era in American politics. It does not bear the hall mark of any eminent financier. It was forced upon the country as the only consistent alternative of the victorious party in the unfortunate contest which humbled the Second Bank of the United States and made it a scapegoat. For almost twenty years the ideal of independence was strictly adhered to. When in 1861 Congress permitted the deposit in banks of the proceeds of certain government loans, the secretary of the treasury regarding the permission as an emergency measure did not see fit to use it, announced his adherence to the principle of the independent treasury and so established it all the more firmly. When in 1863 the founding of a system of banks under federal control made the original arguments for maintaining an independent treasury no longer valid, popular prejudice was too strong to permit the national banking system to come into the full estate which reason and considerations of economy would accord it. During the half century that has supervened Congress has enlarged the use of the banks as custodians of public money, but in no case has this use been made mandatory. The discretion has rested with

the administration surrounded with abundant and, in cases, humiliating safeguards.

Besides the treasury at Washington there are nine sub-treasuries in as many of the larger cities and fourteen mints and assay offices. It is the theory of our system that all funds of the government, on hand at any time, shall be actually stored in the vaults of these twenty-four institutions in the form of "money," that is to say, in coin, bullion, notes and certificates, as in the treasure chest of some mediaeval war lord.

Since our federal revenue is so largely derived from indirect taxation the streams rise and fall with the course of certain lines of trade and rarely coincide with disbursements over any considerable period. Owing to this uncertainty in the rate of income, there is nearly always a surplus and, normally, the excess of income over outgo determines the magnitude of the treasury hoard and the amount of the circulating medium of the country condemned to idleness. In the year 1899 receipts from all sources exceeded disbursements by $100,791,521, while in 1909 disbursements exceeded receipts by $118,795,919.[1] This indicates a range between the greatest surplus and the greatest deficit in a single decade of more than $219,000,000, and even in the year of greatest deficit there was at the close, exclusive of trust funds and the gold reserve, a balance of over $65,000,000 in the treasury offices. The largest cash balance actually held in the offices of the treasury at the end of any fiscal year in the last decade was $255,257,493 on June 30, 1907, and the smallest was $214,206,233 on June 30, 1900. These sums include the gold reserve and in both instances represent approximately ten per cent of the entire money circulation in the country.[2]

These sums are significant from the point of view of their absolute magnitude and also from that of their variability. In all cases they consist of money capable of use as bank reserves. It is true that national banks may not count banknotes as part of their reserves, but since such notes are used as reserve by state and private banks, the distinction may be ignored. It may be said also that the cash reserve of banks is made up of the surplus circulation of the country. So long as there is a deficiency of money for the needs of trade it will not be deposited, or if deposited will not remain in the

[1] Finance Report, 1909, p. 117.
[2] Finance Report, 1909, p. 233.

hands of the bank. It follows that this entire sum of over $200,000,000, if not held by the treasury, would be added to the bank reserves, eliminating exports of gold, and would increase the cash holdings of all institutions doing a banking business by about seventeen per cent on the average. The effect of such an increase in cash reserves would depend on various circumstances. In the case of some banks it would further establish the convertibility of their demand liabilities without affecting the magnitude of these liabilities. In the case of others, by increasing the lending power it would tend to decrease the rate of discount and so the cost of conducting business in general. This diminution in the costs of competitive business, other factors remaining constant, would tend to lower prices of consumers' goods.

The first and most obvious objection to our practice is found in the social loss involved in the idleness of pecuniary capital. At a time when the country is agitated over rising prices and waste of resources, it may be worth while to consider this item of extravagance in our fiscal system.

Position of Bank Reserves in the Credit System

The significance of the segregation of treasury funds lies in the relation of money to bank credits and the analogous relation of these bank credits to the extent of industrial and commercial operations. The credit system of the country has been compared to an inverted pyramid resting on a relatively small volume of money and subject to alternate contraction and expansion with every variation in the volume of the money support. In so far as credit applies to the demand liabilities of the banks the illustration is apt enough, but as applied to credit as a whole it is not quite adequate. The deposit liabilities of the central reserve city banks approximate four times their stock of lawful money under ordinary commercial conditions. But these deposits in turn may represent half the reserves of reserve city banks where lawful money may legally and practically support a volume of deposit credit eight times its magnitude. But the deposits in reserve centers may constitute reserves for a much larger number of country banks and trust companies, in which a given volume of actual money may support liabilities varying from ten to twenty times its magnitude. When we include in our concept of a credit system the obligations of business men and firms whose

"cash" reserves consist entirely of deposits subject to check it will be apparent that the structure of such a system is rather like an inverted bell with widely flaring rim.

The banking business socially viewed is not an end in itself. It is essentially a device for liquidating private credit. The most important function of a bank is to exchange its own credit capable of ready circulation for private credit which lacks that quality. Indeed, if the notes and acceptances of individuals and firms could have the general acceptability of bank obligations no use would remain for the common commercial bank. Practically all the assets of a bank under the head of loans and discounts consist of these sound but relatively sluggish forms of credit and over against these stand its own deposit liabilities. Since many private credit transactions never get into bank, it follows that the total volume of commercial credits is greater by far than the aggregate loans and discounts or resulting deposits of the banks.

Even though many credit transactions may be settled without resort to cash funds, the fact remains that the safety of the debtor is measured by the certainty of his ability to convert his own goods or credit into bank credit at or before the maturity of his obligation. It follows that the great body of bank patrons are as vitally interested as the banker himself in any influence which affects the ability of the banker to perform his function. On the assumption that private obligations offered for discount are fully secured with respect to their ultimate discharge, the ability of the banker to serve his customer is only limited by the relation of his money supply to the volume of his own liabilities and the rate at which he may be called upon to discharge them. It appears, therefore, that the public is vitally concerned with all factors which bear upon the magnitude and stability of bank reserves, since every man's solvency depends on his ability to meet with reasonable promptness his maturing obligations. The safety of the merchant may be in jeopardy not only when the banker fails to pay his check, but just as truly when he is unable to discount his secured paper.

The waste involved in the idleness of public funds is less objectionable than the successive expansion and contraction of reserves which result from the receipt and disbursement of revenue. One phase of this movement may be illustrated by the simple case of a pension disbursement. On August 4th the treasury drew pension

checks amounting to $14,970,000, and distributed them throughout the country. About half of this sum was drawn upon the assistant treasurer at New York. Coming into the hands of country banks, cashed or deposited, these checks are mailed to New York correspondent banks for credit. In a few days this mass of checks is presented to the New York sub-treasury through the clearing house and an equivalent amount of money is transferred from the sub-treasury to the banks whose combined reserves, in the absence of countervailing debits, are increased $7,000,000. Without any alteration in the aggregate wealth of the country or even of New York City the lending power of New York banks is raised about $28,000,000. In order that this new source of profit may be utilized, since nothing in the situation operates immediately to stimulate the demand from commercial sources, the competition of banks in an effort to place their funds lowers the call loan rate. This reduces the cost of carrying stocks and stimulates speculation for the rise in Wall Street.

To reverse the illustration let us suppose that the collection of duties at the port of New York in a given week reaches the not uncommon sum of $10,000,000. This amount of money is drawn from local banks and trust companies and locked up in the sub-treasury. In as far as the effect on reserves and lending power is concerned, it might quite as well have been sunk in New York harbor. The rate for call loans rises, stocks fall or commercial paper which otherwise would have found a ready market remains unsold and the production and exchange of goods may be curtailed.

Unable to foresee these fluctuations in reserves and the consequent fluctuations in the lending power of his banker, the merchant is constrained to carry a much larger cash reserve (bank deposit) than would be carried otherwise, and the interest on this is the price he pays for this particular form of insurance, a charge that is ultimately shifted to the consumers of the goods he offers for sale or to the producer from whom he buys. By the same token, each banker in a system which presupposes independence and the absence of any joint responsibility, carries a large fund of capital devoted to no more productive purpose than as an insurance fund. This fund of ready money tends to be largest in times of stress when the needs of commerce are greatest. Witness the abnormally large reserves carried by country banks on the occasion of the report to the comp-

troller on December 3, 1907. This added cost to the banker's business is paid in higher discount rates and tends to shift to the price of commodities.

Disadvantages Culminate in New York

These movements of money from a state of vitality to one of inactivity take place in every locality provided with a sub-treasury, but they are most significant in New York. In the clearing house there the daily balances are settled in United States notes or gold certificates. The net result of these clearing operations in the month of November, 1907, was a loss for the banks of $12,000,000, and in December it was $4,000,000 more. That this movement of money tended to increase rather than allay the prevailing anxiety no one can doubt. During 1908, when business was depressed and loanable funds abundant, the net result of clearings was a gain to the banks in every month. The largest gain was in April, when $40,000,000 was added to New York bank reserves, and the smallest was in September, when over $16,000,000 was transferred from the treasury to the banks. The total gain of the New York banks from the treasury in this year of low revenue and large disbursement was over $384,000,000. While the banks were gaining in New York they were often losing to the treasury at other points, but the net gain of banks in general was great and the effect in New York was seen in the remarkable bull movement in stocks which began in the spring and culminated just before the death of Harriman, in August, 1909.

The largest source of revenue is in the import duties, amounting in the fiscal year just closed to $333,683,445.03. About two-thirds of these duties are paid into the sub-treasury at New York mainly from the banks of that city, and a correspondingly large part of the disbursements are made from that sub-treasury and pass to the local bank reserves. It happens that gold drawn for export is taken as a rule from the same group of banks. New York bank reserves stand in a peculiar relation therefore to our foreign trade. When imports of commodities are heavy, as they have been during the past fiscal year, the payment of duties tends to coincide with a rise in foreign exchange and threatened or actual gold exports causing a double drain of bank reserves. In this situation, it would be suicidal for New York bankers to purchase time paper with the same liberality as can be practiced by the bankers of Chicago or St. Louis. In

order to protect themselves against this double drain of funds they must lend a large portion of their credit on call or adopt the alternative policy of excessive reserves. That is to say, the ordinary stock exchange loan is utilized as an auxiliary reserve in New York much as the investment in New York exchange constitutes an auxiliary reserve for the country bank. Whatever may be thought of the expediency or morality of the stock exchange loans which represent more than a third of the credit assets of New York banks, the relation of our fiscal system to the case is obvious.

The arguments which led to the segregation of public funds before the Civil War have no force to-day. The most important purpose in establishing the independent treasury was to secure the safety of funds which, on the expiration of the charter of the Bank of the United States, were deposited in state banks. Over these institutions the government had only indirect control and the states exercised but little or none. Whether the state banks of that day were worthy of confidence need not be debated now. The situation was radically changed by the establishment of national banks, and has gradually improved as the banking business has been more fully understood and as comptrollers of the currency have developed an increasingly effective body of administrative regulations. During the last forty years the average loss to depositors in national banks has been but .0807 of one per cent a year. Had all government funds been included among these deposits with no more protection than was accorded general creditors the loss during the year of largest deposits would have been about $205,000. While this is not a sum to be thrown away, it is less than half the annual salary budget of the treasurer's office. But when the government has intrusted any funds to the care of the banks it has assumed the rôle of a preferred creditor. Had the national banking system been treated from the outset as a fiscal agency with the government protected by a prior lien, losses from bank failures would have been negligible. The practice of the government, therfore, cannot commend itself to-day on the ground of either safety or economy.

Another reason for the isolation of public funds was the possible political corruption that might arise from an alliance between private corporations of great power and the fiscal establishment. Whatever ground there may be for such a fear must be in the memory of the political machinations of the Bank in Jackson's first

term, when the officers of that institution, put upon the defensive, unwisely accepted the challenge of the President. There was nothing in the history of the first bank to warrant such a fear, nothing in the first sixteen years of the second one. Every state and municipality in the country deposits its funds in banks and the aggregate of these public funds is great. The writer has never heard a charge of political corruption beyond such as grew out of the rivalry between institutions competing for the custody of funds. This situation would not arise where a bank or group of banks had been established with specially defined fiscal functions as is the case in Europe generally. A method may long survive its usefulness without objection if indeed it be harmless. From this point of view the independent treasury is open to attack. It is not harmless nor merely wasteful. It establishes an irreconcilable antagonism between the commercial interest and the fiscal interest in the circulating medium. We have been extremely zealous that Cæsar may get Cæsar's and forget that the money of the country has another and generally more important function than to serve as the material embodiment of the assets of one of our public treasuries.

II. The Lending of Public Funds to Banks

The funds of the federal treasury arise from every nook and corner of the country, as one must realize by a thought of the ramifications of the postoffice alone. Notwithstanding the number of sub-treasuries, mints and assay offices, the convenient conduct of government business has necessitated other places of deposit and disbursement, and 418 national banks are now designated as regular public depositories. The Secretary of the Treasury selects these banks and indicates the sum which each may hold as determined by the fiscal operations on hand or contemplated in that locality. These banks, unless special arrangements are made, must transfer to the treasury all public money received by them in excess of the limit fixed by the secretary, and these transfers, together with any others made in the course of public business, must be made at the expense of the banks involved. While the banks must give acceptable security for the deposits so held, they do not pay interest upon them nor treat them in any other way as different from private deposits subject to check. At the end of the fiscal year just closed deposits of this character amounted to $51,536,236.30, held to the credit of the

Treasurer of the United States and to that of the various disbursing officers, except postal funds, which are under control of the Postmaster-General. Until 1902 the security held by the government was in the form of its own bonds, but since that date other bonds, such as are legal investment for savings banks in New York, New Jersey, Massachusetts and Connecticut, are accepted as security.

The relation between the treasury and the depository banks may be regarded as normal and may need no comment. In so far as public funds are so held, our treasury policy is free from the criticisms that have been set forth above.

In addition to these regular depositories, 963 national banks are privileged to hold what are called "special deposits" of public funds, and it is these funds which are properly regarded as loans. They are solicited by the banks; they bear interest at the rate of one per cent per annum, since June 30, 1908; they are secured by collateral and they are made payable at a specified time, or on reasonable notice. These loans differ from true deposits in that they are exempt from the legal reserve requirements. These funds are equivalent to a temporary increase in banking capital and serve to augment reserves instead of constituting a burden upon reserves as is the case with deposits in the true sense.

The sums so held by banks are subject to wider variation than those held in the treasury offices. The largest sum loaned in this manner during the last decade was $256,920,155, in December, 1907, while the smallest was in the year just closed, the amount of so-called special deposits on June 30, 1910, being but $4,144,000.

The method employed in these operations may best appear from the words of the Treasurer in his report for 1909:[3]

> The balance in banks to the credit of the general fund on October 31, 1908, was $120,279,145.98. Owing to the large disbursements made from the treasury not equaled by income, the Secretary of the Treasury on November 18th issued a call to 839 special depository banks throughout the country for the return to the treasury by each on or before November 30th, of $5,000 of the public moneys deposited therein. . . . The balance in banks to the credit of the general fund was reduced to $113,578,810.64 by December 3d and decreased slowly thereafter until the close of December, when it became $110,148,907.30. Early in January (1909) it became apparent from the large disbursements being made that it would be necessary to recall to the treasury additional deposits from banks, and accordingly the Secretary on January 11th

[3]Finance Report, 1909, p. 144.

issued a call to the depository banks throughout the country for a return to the treasury of a part of the public moneys deposited with them payable as follows: On or before January 23d, $17,717,700; on or before February 10th, $6,804,060.

The transfer of funds to and from the banks is made in lump sums roughly corresponding to the relation of income to disbursement, but at any particular moment at the arbitrary discertion of the Secretary. Since an ample working balance is kept in treasury offices, the public generally is unable to tell when these pseudo-deposits will be called or when they will be increased. The result is a speculative uncertainty which neutralizes in a great measure the benefit sought to be given by the distribution of otherwise sequestered funds. The scheme is not automatic in its operation and does not respond immediately either to fiscal or to commercial conditions. A characteristic sentence from the money market column during last winter ran as follows: "Stocks opened strong at fractional advances over last evening's close, but a persistent rumor that the treasury was about to make a call on the banks induced selling and the close was weak with losses of a point or more all over the board."

During the somewhat drastic liquidation running through the year 1907, repeated appeals were made to the treasury for funds, and these were interspersed with protests against withdrawals. The secretary seems to have accepted this new responsibility as a monitor of the money market, and responded to all such calls as the surplus revenue made possible. When the pressure on the banks reached the panic stage in November, the limit of public aid had been reached. Then followed that most remarkable proposition to sell $100,000,000 in three per cent treasury notes for the express purpose of relieving the straitened situation into which the dealers in private credit had allowed themselves to drift.

Prior to the administration of Secretary Shaw the placing of special deposits had taken place with reference to the needs of the treasury, at least such was the common impression. But in 1906 the Secretary in his annual report announced the doctrine that his office should frankly accept the duty of regulating the money market by judicious distribution or withdrawal of public funds. He says:

If the Secretary of the Treasury were given $100,000,000 to be deposited with banks or withdrawn as he might deem expedient, and if in addition he were clothed with authority over the reserves of the several banks, with power to contract the national bank circulation at pleasure, in my judgment no panic, as distinguished from industrial stagnation, could threaten either the United States or Europe that he could not avert. No central or government bank in the world can so readily influence financial conditions throughout the world as can the Secretary of the Treasury under the authority with which he is now clothed.[4]

This remarkable and ambitious program did not attract very wide attention at the time it was announced, but the events which immediately followed give it a place of historical importance along with the actions of Secretaries Boutwell and Richardson, and the pronouncements of Spaulding and Butler in the old greenback days. The report had hardly come from the bindery before one of those historic periods of liquidation had begun. "The authority with which the Secretary is now clothed" was appealed to with the result that public deposits were expanded to the extent of over $200,000,000 to be followed by a "panic in distinction from industrial stagnation" of the most typical sort.

It is impossible to believe that any special powers of regulation or any special funds in the hands of the Secretary for that purpose could have affected the situation substantially. The policy of Secretary Cortelyou was in full accord with that of his predecessor. Public funds were unusually abundant and these were nearly exhausted by efforts at relief in the preliminary stages of liquidation, so that when the crash did come in October, little was left but a fiat, an instrument which fortunately has ceased to be invoked since the resumption of specie payments.

So long as we must adhere to the principle of the independent treasury and a policy of surplus financiering, it is doubtless well to permit the deposit of special public funds. The arbitrary doling of these funds to banks which bear no direct relation to the communities from which the funds arise must be regarded as a lame expedient. Moreover, it must be dangerous to business interests to place on the shoulders of a Secretary a responsibility for which his training and experience may have given but indifferent equipment and to accord him the power to stifle or stimulate the growth of

[4]Finance Report, 1906, p. 49.

private credit with which his official position has no direct connection. In the long list of able men who have held that responsible position, there are not many to whom the business interests would readily accord such power.

There is no more reason why the members of the banking profession should stand before the public treasury hat in hand than that any other group of business men should do so. It is only a few years ago that a considerable political party was demanding that the government lend capital to the farmers on mortgage. Would it be any more preposterous for the Secretary to have a special fund from which he would anticipate the foreclosures which follow a season of poor crops than that he have such a fund with which to soften the fall of a structure of bank credits which is toppling under its own weight? At any rate, it may be said in favor of the farmers' contention that they were willing to pay two per cent for the accommodation.

Of course farm credits are not like bank credits, and the provision of a special fund has not been made in either case. Moreover, it may be said that the evils involved in treasury loans are less than the evils in the alternative of segregated public funds. Our experience here simply emphasizes the vices of the original system and enforces the principle that credit expansion cannot be controlled except from within the credit system and should not be subject to unnecessary disturbance from without. Credit rises out of conditions in the market for commodities, and it is in that same market that mistakes in credit must be righted. Men who misjudge the market and so borrow or lend too much must suffer the process of correction as truly as must the farmer who realizes that he should have planted corn where he sowed his oats. The money market which is devised to perfect the operations of the commodity market is an extremely complicated and delicate machine and operates automatically. Those who buy and sell there and assume the responsibilities attending their own activity, in the absence of monopoly or fraud have a right to freedom from paternal manipulation, however well intended.

III. The Federal Guaranty of Bank Notes

The third peculiar feature in the relation of the treasury to banks is found in the virtual guaranty of the banknote liability.

This guaranty is not expressed in terms by the law, but is accomplished no less effectively by being indirect. The law places a prohibitive tax upon all notes of banks except such notes of national banks as are furnished in blank by the Comptroller of the Currency. No such notes are furnished except upon application of a bank depositing with the treasurer, United States or other acceptable bonds or depositing other securities with a national currency association under conditions laid down in the act of June 30, 1908. Any of these notes when properly signed and issued by the bank are acceptable for all payments to the United States, and through such acceptance the government guaranty is affected.

The volume of notes outstanding on June 30, 1910, was $713,430,733; all of these are secured by the deposit of United States bonds, since no banks have as yet availed themselves of privileges of further issue provided by the law of 1908.

The history of our national bank currency is too well known to be recounted here further than to say that like the independent treasury itself it grew out of conditions that are wholly passed away. These conditions were first a system of unrelated and poorly regulated banks on the one hand and the necessity for an extensive market for Civil War bonds on the other. In the absence of either of these conditions it is not likely that such a bank-note system as we have to-day ever would have been instituted. Once established the weight of inertia has been against a radical change. Moreover, the good features of the system—safety and uniformity in the currency—were so obvious and the evil effects so obscure that the public generally has shown but little response to the preaching of reform.

In a broad and general way the objections to our system of note issue are summed up in the term "inelasticity," and this inelasticity results from the measures which the government adopts to protect itself and justify its guaranty. Not only is it true that the volume of notes in the aggregate does not rise and fall with the varying need for a circulating medium in the country at large, but more important still the issues of a particular bank cannot be adapted to the needs of its particular patronage. Associated with this failure to respond to the needs of trade is another quality open to condemnation; that is the quality of expansion and contraction in response to the state of the bond market as distinct from that of the commercial credit market.

With respect to the note issues as a whole, it will be recalled that every national bank must own and deposit with the government a minimum portion of its capital in government bonds. Banks which have no real need for notes seldom fail to utilize this compulsory bond deposit for an issue of notes. For all purposes save as a reserve against deposits this minimum note issue is in effect a replacement of banking capital forced by the banking law to take the form of a relatively unprofitable investment.

Assuming that a bank is founded for the purpose of earning profits in the banking business and that the capital originally contributed corresponds to the banking needs of the particular patronage to be served, the effect of the law is to force an unnecessarily large capitalization. And this is coincident with an inflation of the circulating medium, to the extent that notes are issued against the enforced deposit.

Coordinate with this force which makes for inflation is the absence of any effective and automatic machinery for contraction. There is but one redemption agency and that is at Washington, well removed from the ordinary channels of trade. The great volume of circulation never reaches Washington save as it is withdrawn from the course of trade and expressed at considerable expense. No distant bank has any adequate motive for incurring that expense except when notes are worn and mutilated. The result is that this circulation has largely lost its character as a demand liability of the banks and amounts to a virtual exchange of government notes for government bonds. If the government should issue $700,000,000 of legal tenders, put them out in the redemption of its own bonds, the situation with regard to the circulation of the country would be but slightly different from what we have. Such is the aspect which the note issues take when viewed as a whole.

With respect to particular banks and particular communities, the objections to our practice are even greater. It has been shown that the object of a bank is the purchase of private credit in forms unadapted to general circulation by giving in exchange its own credit in forms that are adapted to general circulation. These forms are the note and the checking account. If the bank is left to its choice it will use either the note or the deposit or both, as its customers demand. Since the aggregate of its liabilities is practically limited to the aggregate of private paper offered for discount, any limita-

tion on its power to contract obligations operates as a limit on its power to discount or afford accommodation.

Since there is in this country no legal limit to the deposit-liabilities, save in the reserve requirement, those communities which habitually use checks and have no use for notes find their banking facilities also unlimited except as by reserves. On the other hand, those communities accustomed to money payments find their banks shackled by the maximum limit to the note liability on the one hand and burdened by an unprofitable bond investment on the other. The significance of this may be clear by the experience of a country bank in the West with $100,000 cash capital. If the community uses checks instead of money, this $100,000 will support loans and consequent deposits of at least $400,000. If, however, it is a money-using community, the bank must invest its money in bonds and extend its liabilities in the form of notes to a maximum of $100,000. That is, in so far as the bank's patronage insists on using money rather than checks, to just that extent the bank's lending power is diminished by three-fourths. Putting the matter in another way, under our system of note issues, in so far as notes are actually demanded by the patrons of banks, we must devote four times the capital to the banking business that would otherwise be required. It is needless to comment on this waste of banking capital and its social significance. Fortunately the use of checks is gradually extending and the burden forced upon us by an unscientific system is growing less under normal business conditions. However, the inconvenience of tight money seasons and the high rates exacted of borrowers at such times are the price we pay for this survival of an ancient régime.

Reports of the comptroller frequently discuss the "profit on circulation" coming always to the conclusion that any such profit is small but real. Such a conclusion would seem to answer the arguments of those who object to the system on the ground that banks earn excessive profit on their notes, as well as of those who object because there is no profit in the notes. The merit of all such discussion turns on the meaning of profit. As against capital lying idle, of course there is a profit in using it as the basis of a national bank note issue. As against the same amount of capital used as a reserve against deposits there is a very real loss on all the capital used as the basis of a national bank-note issue.

As capital engaged in the separate departments of any business enterprise seldom earns the same returns, but is distributed to the departments in such manner as is supposed to yield the most on the whole, just so our national banks, except for the legal requirement of a minimum bond deposit, invest as little in the note issuing function as is consistent with the demands of patronage and as much in the extension of deposits as the same conditions justify. While in Europe to-day, as in America before the war, it is quite possible to conduct a safe and profitable banking business in which all liabilities take the form of notes; such an institution could not survive in this country at all under our national banking law.

That the note issue is generally on the margin of profitableness is evidenced by these facts. Many issues are at or near the minimum bond deposit. A few banks maintain their bond deposit and do not issue any notes at all. State banks without the right of issue compete successfully with national banks in the same communities and substantially the same class of business. As a result of the essential unprofitableness of note issues the total volume of notes rises with any fall in the market price of government bonds and falls with a rise in price of these securities. In the latter case banks retire circulation, retrieve the bonds and sell them for the premium.

One of the worst features of our present system is the fact that it beclouds public understanding of the banking business, especially of the note-issuing function. After forty years of this sort of paternalism it is not strange that a considerable body of persons take the next plausible step and demand that the government guarantee the convertibility of the deposit liability as well.

More recently, as so-called deposits of government funds have constituted a significant temporary addition to the banking capital, there has been a tendency for the note circulation to rise as the deposits decline. The bonds, having been held for security of special deposits, are often left in Washington as a security for new notes. In so far as the new notes are used as reserves by state banks, this change in the national bank liability from the form of public deposits to that of notes may serve to prevent the contraction of credit which would have resulted from the withdrawal of deposits alone.

The foregoing objections to the bonds as the basis of bank

note issues are not removed by the Aldrich-Vreeland Act of 1908. While the new law admits of circulation based on commercial paper, its issue is hedged about by such safeguards as would make it available only in the most acute emergencies. In the first place, no bank can issue notes on this plan except it have outstanding circulation based on bonds to the extent of forty per cent of its capital stock. The amount it may then issue against commercial paper must not exceed thirty per cent of its capital and surplus. The rate of taxation on such notes is so high as to preclude possibility of profit on the issue, and an issue under such circumstances would be an acknowledgment of difficulties which no particular bank would willingly make. Finally, any bank choosing to avail itself of the new privilege of issue must not only convince the currency association to which it belongs of the necessity of such action, but must convince the Secretary of the Treasury as well, for with him lies the final discretion as to the expediency of the proposed increase in circulation. Manifestly, the machinery provided is too cumbrous for use in a real emergency if the law is to be obeyed in its letter and spirit.

The general subject of currency reform is not within the scope of this paper, but it may be said that no solution of that problem will be adequate which ignores the relation of the treasury to the banks. Whether the outcome be a central bank modeled on any of the plans proposed or simply a modification of the constitution and relation of existing independent banks, the treasury hoard must be abolished, the fiscal operations must cease to disturb commercial operations, and the Secretary of the Treasury must be relieved of responsibility for the money market.

NATIONAL BANKING SYSTEM AND FEDERAL BOND ISSUES

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Years count in a country so new as the United States, and the national banking system may be regarded as one of our time-honored institutions. For nearly half a century, the national banks have been dominant among the banks of the United States, which as a whole measure more than one-third of the banking power of the world. Our present national banks, the result of the latest attempt to establish banking by direct authority of the federal government, have long survived the period allotted their predecessors, the First and Second Banks of the United States; and the existing federal system of banks bids fair, if its great prestige at this time and past record are indications, to continue indefinitely as the most important of the several groups or classes of banks operating in the field of credit and exchange.

From the earliest days of banking there has been close intimacy between that function and the needs of government; in fact, banks grew out of such necessities. The Bank of Venice, supposed to have been formed in 1171, was organized for the purpose of funding the public debt. The Bank of Genoa, 1407, had a similar origin; while the Bank of Amsterdam, 1609, was organized to handle more effectively the accumulations of light-weight coins brought into Holland through its great foreign trade of that time. A loan to the government of £1,200,000, its entire capital, was the beginning of the Bank of England, in 1694. The present Bank of France, which has served the people of that country so well since 1800, was founded by Napoleon to act both as a fiscal agent and an aid to commerce. In our own country, the Bank of Pennsylvania, 1780, was organized by patriotic citizens almost solely with a view to financing the war then in progress. The First and Second Banks of the United States were most intimately related to the fiscal requirements of the federal government; and, of all examples

history affords, none can match the tremendous necessities that led to the passage of the national currency act of February 25, 1863, from which dates the beginning of our national banking system.

A civil war, the costliest and most prodigious ever known, was then in progress. The existence of the United States as a nation was at stake. Wars mean expenditure. They are fought by the army, the navy and the treasury. Without the latter, the army could never be recruited and maintained and the navy would be helpless. Some of the greatest battles of the Civil War were fought in the United States Treasury; and Hugh McCulloch, who as the first Comptroller of the Currency, organized the national banking system, and later twice held the treasury portfolio, states, in his "Men and Measures of Half a Century," that, next to Lincoln himself, the man most entitled to the credit of saving the nation was Salmon P. Chase, Secretary of the Treasury. Without any previous financial experience, he was called upon to provide ways and means of financing the war, and the huge sums raised by the various expedients which he employed are appalling in their magnitude even in this day of gigantic figures. The public credit was at a very low state immediately preceding the outbreak of the war. At the close of the year 1860 the national debt was only $65,000,000. With bills maturing January 1, 1861, requiring payment, the then Secretary of the Treasury offered $5,000,000 of treasury notes for sale, and was able to dispose of them only after considerable effort at twelve per cent per annum. At the close of the war in 1865 the total ascertained indebtedness of the United States was $2,807,-951,000.

The federal charter of the Second Bank of the United States expired in 1836, and from that year until 1863 the field for the circulation of bank notes was occupied by the issues of state banks. These at the outbreak of the Civil War amounted to about $202,-000,000, and compared with specie were to a large extent at a discount of from one to five percentum. Lack of uniformity in the paper currency, long recognized as one of the evils growing out of state bank issues, became more troublesome as the war progressed; and one of the two principal reasons advanced in behalf of a national circulation was the desirability of securing a uniform bank currency. The other—and perhaps the determining one—was the necessity of making a broader market for government bonds.

As early as December, 1861, the treasury and all the banks in the United States suspended specie payments. Gold was at a premium and the government was obliged to resort to an issue of $50,000,000 in demand notes. The first legal tender act, passed February 25, 1862, permitted the issue of $150,000,000 so-called "greenbacks." Congress on July 11, 1862, authorized an additional $150,000,000 in legal tenders. By the early autumn of that year the demand notes depreciated below specie by as much as eleven per cent. In the midst of these issues of legal tenders, and with the financial problems of the war becoming more and more difficult, the plan of a national banking system was taking shape. The first official suggestion relating to it is found in the annual report of Secretary Chase to Congress in December, 1861, at which time, however, he seems not to have favored the organization of new banks so much as the issuance of national notes to existing institutions, to be secured by the pledge of United States bonds. The absence of any suggestion in his report favoring the establishment of a banking system indicates clearly that the government was seeking, above everything else, a market for its bonds. Soon after the report was submitted to Congress, Hon. E. G. Spaulding, a member of a sub-committee of the committee on ways and means, entered into correspondence with the Secretary of the Treasury with a view to carrying out the suggestion contained in his report. Mr. Spaulding enlarged upon the idea by drafting a bill based in great part upon the free banking laws of several of the states. The bill was not presented until July, 1862, when it was referred to the committee on ways and means. In the meantime, the treasury was financed through issues of legal tender notes which were immediately available. Another cause of delay was the strong opposition of the state banks to the new measure. At the beginning of 1863, there were 1,466 banks in the United States, with an aggregate capital of $405,000,000, and their circulation at that time had reached $238,677,000. The time had arrived, however, when consideration of the national currency act could no longer be postponed. It was introduced in the house January 7, 1863, and referred to the committee on ways and means, by which, largely owing to the opposition of state banks, it was reported adversely. On January 26 it was introduced in the senate by Senator Sherman. It passed the senate February 12, 1863, the house agreed to it without amendment,

February 20, and it became a law February 25, 1863, by the signature of President Lincoln.

By this act, banks operating immediately under the supervision of the government were permitted to be established, and they were given power to issue circulating notes secured by the pledge of United States bonds and guaranteed by the government. Hugh McCulloch, who had long presided over the State Bank of Indiana, was appointed Comptroller of the Currency. No fitter selection could have been made. His long and successful experience as a banker and his familiarity with the subject, both in theory and practice, admirably equipped him for the responsible work of organizing the new system. In actual operation, the act of February 25, 1863, soon proved to be defective in several important particulars, chief of which was its failure to provide for the redemption of bank notes except at the counters of the issuing banks, for which purpose they were required to maintain a reserve of twenty-five per cent. One of the main objects of the act was to encourage the conversion of state banks into national institutions. It was found to be ineffective in this direction because the state banks were reluctant to abandon their old names in exchange for numerical titles, such as "First," "Second," "Third," etc. These objections and others of a minor character resulted in the repeal of the act of February 25, 1863. This was done by the act of June 3, 1864, which was substantially a re-enactment of the previous law with such corrections as the experience of a few months of actual operation demonstrated to be necessary.

Many legislative changes affecting national banks have been made since the organic acts were passed. Among the earlier, was the act of March 3, 1865, imposing a prohibitive tax of ten per cent on the circulating notes of state banks. This resulted in giving the national banks exclusive circulation privileges, which they enjoy to this day. The tendency of later laws has been to liberalize the system as it has developed strength. In 1874, the system was so far regarded as a fixture that Congress, in passing some amendatory legislation, saw fit to declare "that the act entitled 'An act to provide a national currency secured by a pledge of United States bonds, and to provide for the circulation and redemption thereof, approved June 3, 1864,' was hereafter to be known as 'The National Bank Act.'" A national bank redemption agency was authorized by the

act of June 20, 1874, and this resulted in the establishment of a redemption bureau in the Treasury Department at Washington, the expense of which is borne by the banks according to the amounts of circulating notes redeemed for each during the year. By the same act, the requirement that reserves be maintained against circulation was repealed.

All national banks are chartered for a period of twenty years. Congress passed an act, July 12, 1882, to enable national banking associations to extend their corporate existence for a further period of twenty years and, in 1902, a similar act was passed. The acts of 1863 and 1864 limited the aggregate amount of circulating notes which might be issued to $300,000,000. This limit was subsequently raised to $354,000,000 by the act of July 12, 1870, and was entirely removed by what is known as the "Resumption Act" of January 14, 1875.

It is hardly necessary to review step by step the legislation by which the national banking laws have been brought to their present satisfactory state. The Act of March 14, 1900, which gave finish to, and rounded out, the system, has had a greater influence upon national banking than all the legislation preceding it. Under this act the minimum capital was fixed at $25,000 in any place the population of which does not exceed 3,000 inhabitants. The former minimum was $50,000, and the object of the amendment was to encourage the organization of small banks in communities which were denied banking privileges because of inability to qualify with the larger capitalization. The provision was also intended as an inducement to the conversion into national institutions of state banks having a capitalization of less than $50,000. The act repealed the former law which authorized banks to take out circulation only to the extent of ninety per cent of the market value and not exceeding the par value of the bonds deposited as security therefor, and provided that notes equal in amount to the par value of bonds deposited could afterwards be taken out. Banks were also permitted to take out circulation up to the full amount of their capital, whereas until the date of this act a bank could take out circulation only to the extent of ninety per cent of its capital. The tax upon circulation was reduced from the former rate of one per cent per annum to one-half of one per cent per annum when secured by two per cent

bonds which the act authorized to be exchanged for old issues bearing higher rates.

As the result of the passage of the Act of March 14, 1900, a remarkable development has taken place during the last ten years. In his report to Congress, December, 1909, the Comptroller of the Currency stated: "Since March 14, 1900, the date of the act authorizing the organization of banks with a capital of $25,000, charters have been granted to 4,308 associations, with an aggregate capital of $261,083,300, a number greater by 691 than the number of banks in existence on the date of the passage of the act in question." How great an effect the act has had upon circulation accounts is shown by the statement that on the day it became a law there was outstanding $216,374,795 of notes secured by bonds, while on June 30, 1910, the aggregate was $685,517,013. This increase of $469,000,000 in circulating notes during the last ten years has no doubt had a marked effect upon prices in the United States. At times there has been evidence of redundancy. This is particularly noticeable in the redemptions of circulating notes, which, during the year 1909, reached the enormous total of $489,923,468.

The number of national banks in operation June 30, 1910, was 7,145. Their combined capital was $989,567,114, surplus $644,857,482, undivided profits $216,546,125 and their circulation $675,632,565. Their individual deposits aggregated $5,287,216,312, and their combined resources were $9,896,624,696. The following table from the report of the Comptroller of the Currency shows for 1909 the banking power of the United States as indicated by the volume of capital stock, surplus, deposits and circulation:

	Number.	Capital.	Surplus, etc.
National banks	6,893	$933,979,903	$795,077,107
State, etc. banks	15,598	866,056,465	1,039,548,321
Non-reporting banks[1]	3,021	55,951,000	27,975,500
	25,512	$1,855,987,368	$1,826,600,928
	Deposits.	**Circulation.**	**Total.**
National banks	[2]$4,896,462,203	$636,367,526	$7,261,886,739
State, etc., banks	9,209,462,780	.....	11,115,067,566
Non-reporting banks	389,700,000	.....	473,626,500
	$14,495,624,983	$636,367,526	$18,850,580,805

[1]Number of banks and amounts estimated.
[2]Includes government deposits.

It will be observed from the foregoing that in resources state banks, trust companies, etc., combined, exceed the national banks. The tendency in this direction during late years has led to some agitation in favor of further liberalizing national bank laws so as to permit national banks to make loans on real estate and to accept some other classes of business which now fall naturally to trust companies. There have also been suggestions relating to a change in the law as to the reserves of national banks, in order to enable them to compete with trust companies in this respect. None of these suggestions has taken form as yet, but some of the large national banks of the country have affiliated themselves with trust companies in such manner as to accomplish rather effectively any object that might be attained by permission to engage in business which is now forbidden to national banks.

Although there were in operation, June 30, 1910, 7,145 national banks, 9,803 have been organized since the beginning of the system. Complete figures are not available for 1910, but on October 31, 1909, there had been 9,572 national banks organized, of which 484 were eliminated as the result of insolvency, and 2,063 placed in voluntary liquidation. At that time the affairs of 416 insolvent banks had been liquidated, creditors having received on the average 82.29 per cent of their claims. At the date of failure, circulating notes of these banks aggregated $21,228,613, secured by bonds of the par value of $23,917,150, from which was realized $24,811,757, or $3,583,144 in excess of the circulation for which the bonds were pledged.

From the beginning of the national system to June 30, 1909, taxes paid on circulation, capital and deposits have aggregated $183,662,698.98. In the annual report of the Comptroller of the Currency for 1909, it was shown that the expenses of the currency bureau from 1863 to that date were approximately $25,000,000. Thus the banks have paid to the government over and above the cost of operation of the currency bureau, more than $158,000,000. The tax paid on circulation alone has averaged annually about four times the average annual expense incident to the operation of the currency bureau. This fact has led to the suggestion that the circulation taxes should be further reduced. Even under the liberal provisions of the Act of March 14, 1900, allowing circulation up to the par of the bonds pledged as security, there is still only a small

margin of profit to the banks in their circulation accounts. In his annual report for 1909, the comptroller shows that, with the market price of two per cent bonds at 101.052, the profit on national bank circulation is only 1.334 per cent. The profit on circulation secured by Panama bonds with a market value of 100.595 was only 1.384 per cent, while the profit on circulation secured by 4s of 1925 with a market value of 117.320 was 1.211 per cent.

A section of the Currency Act of June 3, 1864, authorized the use of national banks as depositaries of public funds. This has been amended from time to time. At present any national bank may be designated by the Secretary of the Treasury as such depositary. The banks chosen are required to secure public deposits by the pledge of United States bonds *and otherwise*. The phrase in italics was construed by Secretary of the Treasury Shaw to include state, municipal and railroad bonds. His construction was apparently confirmed by Congress in the Act of March 4, 1907, requiring the secretary to make public a statement before the first of January of each year of the securities required during that year for such deposits. The present Secretary of the Treasury announced last December that for the year 1910 he would accept United States, Philippine, Porto Rican and District of Columbia bonds at par, bonds of Hawaiian Territory at ninety per cent of par, and bonds of the Philippine Railway Company at ninety per cent of their market value, but not exceeding ninety per cent of par. June 30, 1910, there were 1,378 depositary banks, of which 414 held regular accounts. These latter are utilized mainly in the collection of the revenues and in making disbursements. There were 964 temporary or special depositaries with no other function than to hold the funds lodged with them. On all special and additional deposits, that is such as are not required by the treasury to be maintained for its own convenience, banks pay interest at the rate of not less than one per cent per annum on the average monthly balances. June 30, 1910, the depositary banks held to the credit of the treasurer and disbursing officers a total of $52,209,585.

With respect to the withdrawal of national bank circulation, the Act of May 30, 1909, provides that not more than $9,000,000 lawful money shall be deposited in any one month for that purpose. The limit was formerly $3,000,000. This restriction does not apply

to the additional circulation authorized by the Emergency Currency Law.

So far as reserve requirements are concerned, there are three classes of national banks. Those in the central reserve cities of New York, Chicago and St. Louis must maintain in their own vaults against deposits, exclusive of government funds, a reserve of twenty-five per cent in lawful money. Those in forty-six reserve cities must also keep twenty-five per cent against such deposits, but one-half of this may be kept with banks duly qualified as reserve agents in the central reserve cities. All other banks are required to have a reserve of fifteen per cent, of which three-fifths may be kept with banks in either reserve or central reserve cities.

The interest bearing debt of the United States on August 15, 1910, aggregated $913,316,590, as follows: four per cent loan of 1925, $118,489,000; three per cent bonds of 1908-18, $63,945,460; two per cent consols of 1930, $646,250,150; two per cent Panama bonds of 1936 and 1938, $84,631,980. Roundly, eighty per cent of this entire debt is held by the national banks. They have deposited with the Treasurer of the United States $689,123,510 to secure circulation and $38,314,200 to secure deposits of public moneys. The Comptroller of the Currency estimated in his report for 1909 that on September 1st of that year, according to reports of condition of national banks, there was evidenced the ownership by the banks of other United States bonds to the additional amount of $23,145,640. If the unpledged holdings of banks have not been decreased since then their present ownership, including bonds deposited as security for circulation and public moneys, would aggregate $750,583,350, leaving only $162,733,240 held otherwise than by the banks. It is probable, however, that some of the unpledged bonds then reported have found their way to circulation accounts during the year. This enormous holding of government bonds is largely the result of legislation contained in the Act of March 14, 1900. Among other things, that act provided for refunding the national debt, except that portion of it represented by the 4s of 1925, of which there are now outstanding $118,489,000. There were refunded: 3s of 1908-18 to the amount of $132,449,900, 4s of 1907 to the amount of $441,728,950, and 5s of 1904 to the amount of $72,071,300, making a total of $646,250,150 bonds bearing three per cent, four per cent and five per cent interest, refunded into consols of 1930 bearing two per

cent interest. The exchange was effected at a net profit to the government of $16,551,037.54. As the new consols were favored in circulation accounts by a reduction of the tax on circulation to one-half of one per cent per annum, as against the old rate of one per cent, they naturally found ready market with the banks. Out of a total issue of $646,250,150 consols, they have lodged at the treasury either as security for circulation or public deposits, $603,916,700. The Panama issues, which have the same circulation privilege, aggregate $84,631,980, and these were sold at a premium of $2,677,-614.83. The banks have on deposit at the treasury $82,321,020 of these bonds either as security for circulation or deposits. These figures show that the market for our low interest bearing bonds has been found almost exclusively with the banks. It was always an artificial market, resulting from special inducements, and was almost wholly unrelated to an investment basis. The 2s of 1930, during the period of surplus revenues, from 1903-1906, sold as high as 110 in the market, at which time British consols bearing two and three-quarter per cent were selling below 90. Many banks purchased bonds at high premiums in order to qualify as depositaries of public moneys, and it has been estimated that on the whole the average cost to the banks of their enormous holdings of the consols is in the neighborhood of 105. The deficient revenues in recent years have resulted in great withdrawals of public moneys from the banks. From as high as $249,233.643 on December 27, 1907, deposits fell to $33,-764,569 on April 5, 1910, releasing among other securities many millions in government bonds. With an important avenue for their use thus closed, prices fell to points dangerously close to par. As a result of this decline it has been estimated that banks have suffered a depreciation in premiums on government bonds anywhere from $25,000,000 to $30,000,000.

Such was the state of affairs when the Tariff Act of August 5, 1909, was passed, which contained legislation authorizing an additional issue of $290,569,000 bonds to complete the construction of the Panama Canal. These bonds are to bear interest at a rate not exceeding three per cent. The Act of June 28, 1902, authorized $130,000,000 Panama bonds to bear interest at the rate of two per cent per annum, and of these $84,631,980 have been issued. As shown above, with the exception of a little over $2,000,000, they are all owned by national banks and were sold by the government

at prices ranging from 102.2778 to 104.036. Even before the passage of the Act of August 5, 1909, it had become apparent that the government could no longer market a bond bearing a rate as low as two per cent. The artificial market was exhausted; and, owing to the redundancy following the currency panic of 1907, the national banks were having great difficulty in keeping their notes in circulation. There had been a great increase in circulation during and immediately following the panic. October 1, 1907, the outstanding bond secured circulation was $556,101,330. In three months it rose to $643,459,898; and, notwithstanding the general decline in business which was the aftermath of the great disturbance in 1907, it never sought retirement. Thus with circulation accounts full and overflowing, the bank market for low interest bearing bonds practically disappeared. When, therefore, the tariff bill was introduced in the senate the chairman of the committee on finance of that body announced that legislation would be required in the pending bill to change the character of the bonds which may be issued. He admitted that the twos could only be purchased by or for the national banks, and that it would not be possible to sell to individual investors a considerable amount of bonds of this character at par.

The bond legislation contained in the Tariff Act of August 5, 1909, fixing three per cent as the maximum rate of interest which the bonds may bear, seems utterly to have disregarded the equities involved in the enormous bank holdings of the two per cent issues. Leaving the tax on circulation to be secured by the new bonds at one per cent, it discriminated against the 2s. The reduction in the circulation tax by the Act of March 14, 1900, was to make refunding attractive and to induce the banks to part with their holdings of three per cent, four per cent and five per cent bonds in exchange for the two per cents. An increase of one per cent in the interest rate would have required, in order to establish a parity between the new bonds and the 2s, that there be also an increase of one per cent in the tax on circulation secured by the 3s. In other words, to place the proposed new 3s on the same footing with the old 2s, the tax on circulation secured by the former must necessarily be one and one-half per cent, the tax on the latter being one-half of one per cent. An effort to introduce some such provision into the law failed, with the result that notwithstanding the treasury was in need of funds to meet canal expenditures, it has never been able to avail

itself of the bond authorization in the tariff act. The Secretary of the Treasury was compelled to announce that the Treasury Department would not issue any of the new Panama bonds before the next Congress had had the opportunity to change the circulation tax, and he declared that he felt it a duty of the government to see that the two per cent bonds have the protection of a parity. In the meantime if treasury conditions demanded it he proposed to sell only three per cent certificates of indebtedness with a term limited to one year. These latter were originally authorized by the War Revenue Act of 1898, and this authority was confirmed and enlarged by the Tariff Act of August 5, 1909. No occasion has since arisen for a resort to temporary certificates, but the general fund of the treasury, out of which Panama expenditures have been met, was entitled to reimbursement on August 15, 1910, in the sum of $121,228,305.66. Congress has not yet seen fit to take any steps to relieve the situation, and the bond authority of the recent tariff act is still regarded as unavailable. The disinclination to make the necessary adjustment of the circulation taxes is understood to be due to the desire not to introduce any financial legislation into a situation which the National Monetary Commission, authorized by the Emergency Currency Act of May 30, 1908, and now engaged in a study of the currency, wishes to control.

Following the currency panic of 1907, great pressure was brought to bear upon Congress to amend the banking and currency laws in such manner as to prevent a recurrence of similar trouble. This led to the passage of "An act to amend the national banking laws, approved May 30, 1908," popularly known as "The Emergency Currency Law." It is to expire by limitation on June 30, 1914. Meantime should there be an emergency which in the opinion of the Secretary of the Treasury would justify additional bank circulation, it may be taken out in either of two methods prescribed by the act as follows:

1. National banks occupying contiguous territory may organize a national association. There must be at least ten national banks in each national currency association, and the aggregate capital and surplus of such national banks must be at least $5,000,000. No national bank may join a national currency association unless it has an unimpaired capital, and surplus of not less than twenty per cent. After the formation of an association any national bank belonging thereto, whose outstanding circulating notes actually issued against

United States bonds amount to not less than forty per cent of its capital may obtain additional circulating notes by depositing with the association in trust for the United States any securities, including commercial paper. But additional notes will only be issued upon the recommendation of the Comptroller of the Currency and the approval of the Secretary of the Treasury, and then not exceeding seventy-five per cent of the cash value of the securities or commercial paper so deposited. There is a proviso also that no national bank association shall be authorized in any event to issue circulating notes based upon commercial paper in excess of thirty per cent of its unimpaired capital and surplus.

2. National banks possessing the same qualifications as to unimpaired capital and surplus required of banks joining a national currency association, and whose circulating notes outstanding and actually issued against United States bonds are equal to forty per cent of its capital stock, may obtain additional circulating notes not exceeding ninety per cent of the market value but not in excess of the par value of bonds or other interest bearing obligations of any state of the United States, or any legally authorized bonds issued by any city, town, county, or other legally constituted municipality or district in the United States which has been in existence for ten years and which for a period of ten years previous to such deposit has not defaulted in the payment of any part of either principal or interest of any funded debt authorized to be contracted by it, and whose net funded indebtedness does not exceed ten per cent of the valuation of its taxable property.

State, city, town, county and other municipal bonds of the character described above are also acceptable as security for additional circulation taken out through the medium of a national currency association, and will be received by the treasury at ninety per cent of the market value, but not exceeding par. The limit of such additional circulation is placed by the law at $500,000,000. Additional circulation is subject to a tax of five per cent per annum for the first month, which is increased one per cent per annum each month thereafter until it reaches ten per cent. No occasion has yet arisen for the use of any of this circulation, but the treasury has made complete preparation for it by having $500,000,000 printed which is held in stock ready for issuance in case conditions should require it.

The national banks of the District of Columbia were the first to organize a currency association. They formed one June 18, 1908, largely at the instance of the then Secretary of the Treasury, who desired that the capital should set an example for the rest of the country. No other associations were organized until the summer of 1910, when Secretary MacVeagh made an effort to induce other

sections of the country to provide and have ready a workable equipment so that there might not be any delay in the event of a necessity for issuing additional circulation. As the result of this effort there have been formed currency associations in New York, Boston, New Orleans, Philadelphia and Atlanta, Ga. As this is being written many other sections have under consideration the formation of associations.

The latest legislation having a bearing upon either national banks or government bonds is to be found in the Act of June 25, 1910, to establish postal saving banks. This law authorizes an issue of two and one-half per cent bonds, but they are not available as security for national bank circulation. In case postal deposits should reach any considerable figure some portion of them might be invested in these bonds, thus placing the treasury in funds and avoiding, for a time at least, any financing on account of the Panama Canal.

There is also a possibility that the proceeds of the two and one-half per cent bonds authorized by the postal savings bank law might be utilized in refunding the $63,945,460 United States 3s of 1908-18 which are payable at the pleasure of the government at any time before August 1, 1918. If a central bank of issue shall ever be established, supplanting the national banks in their note issuing functions, a very great problem must be solved as to the disposition of the present enormous bank holdings of government bonds. It is thought by some that the postal savings bank law may afford relief in this respect; but, in order to do this, the growth in postal savings deposits would have to exceed anything that the most ardent advocates of that scheme have ever claimed for it. Postal saving banks have been in existence in England since 1861. In 1908, their deposits were in the neighborhood of $782,000,000. It may not take so long in the United States to develop a postal savings bank system with that amount of deposits, but it will probably be many years before this figure is reached. Nothing less than such a sum would suffice to relieve the banks of their holdings of government bonds should the circulation privilege be transferred to a central institution.

It will be observed that the history of national banking is closely interwoven with that of government bonds. Forty-seven years ago the system was established to help make a market for them. The

banks rendered noteworthy service in refunding the war issues during the period from 1870 to 1879, and finally under the stimulus of the Refunding Act of March 14, 1900, they were induced to become the holders of a very large part of the national debt, their ownership now representing four-fifths of the whole.

In the main the national system has worked well. It has unquestionably furnished a perfectly secured and a uniform bank note circulation, but it has failed in one important respect. Circulation has never been responsive to the business requirements of the country. It has almost invariably expanded when it should have diminished, and contracted when it should have expanded. Related as note issues are to government bonds, circulation has followed the price of these securities in the market and not the volume of business. Lack of elasticity is the vital defect of our bank currency. Chambers of commerce, bankers' associations, congressional committees, comptrollers of the currency and secretaries of the treasury have for years sought the solution of this problem. The remedy is yet to be found. Perhaps the Monetary Commission will find it.

ENLARGEMENT OF CLEARING HOUSE FUNCTIONS

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Though clearing houses have long existed, the fact that these associations were established for one special purpose appears to have clouded the further fact that their existence creates an organization susceptible of uses other than those at first contemplated. Of late years, development has occurred in channels of much importance and it is interesting to note these as indications of possibilities of the future.

To Boston belongs the credit of the first step in enlarging the functions of a clearing house association through the installation of a system for the collection of country items. The example set by Boston has been followed by other clearing houses with results both satisfactory and economical. Under such a system of what may be termed the country clearing house the work of the transit department of each bank is materially reduced. Various rules have been or may be adopted by the individual clearing house, but the main principle is in all cases the same, viz., to effect collection through one channel, with the consequent advantages of saving in rate of exchange, in postage, and in labor; besides control is kept of the disturbing factor of exchange charges. Small items upon which a minimum collection charge would be made are thus collected as a part of a total letter at a large saving through pro rating the exchange charge, as well as through saving in office costs. It need not be pointed out that the power exercised by such an organization, and the pressure that may be brought to bear in lessening charges are great. In consequence strides have been made in the matter of economy in the collection department which would have been impossible for individual banks. In Boston costs have now been brought to a nominal figure and in other centers a large reduction has been made; in Kansas City the cost is now less than half that ruling at inception

of the system in 1905, and a further reduction is being constantly made. Costs are pro rated to each bank, so that each is accurately charged in proportion to the amount of its items. The system has worked admirably and its advantages are obvious, not only in the saving effected but in the control which can be exercised over all exchange questions through the organization now at the disposal of clearing house committee. There are few questions more troublesome than that of exchange and no apology is required for a system and organization which tends to lessen its difficulties.

A movement of greater consequence has been started through the installation of the office of clearing house examiner in many centers, and the credit for this movement belongs to Chicago. Much has been written with regard to the general work of clearing house examinations, but little has yet been said as to the possibility of further development through such an office, more especially with regard to the question of credit information. The original objects sought in the installation of the office were to detect instances of unsound banking in any direction, to note duplications of borrowings by the same client at different banks, and to enable the clearing house to take preventive rather than remedial measures by applying an earlier remedy than is possible for national or state officials, and by such early action to remove unwholesome conditions from any bank in the association. It has long been recognized that no bank can be in unsound condition without hurt to the whole local banking community; the supervision of the clearing house is therefore justifiable and if such supervision be sufficiently close and all irregularities be promptly checked, it becomes possible for the confidence of the public to be restored during any unwarranted run on an individual bank by the announcement of clearing house support; panic may be thus averted, and with the examiner's organization now existing it is practicable for the clearing house as a body to exercise such supervision of any weak bank as to amount to a virtual taking over of its management till it is again in sound condition.

Further possible developments are now becoming apparent. We are but at the beginning of the era of usefulness of such departments, and careful analysis tempts the belief that in the extension thereof may lie a partial solution of many grave difficulties that beset our banking system.

Consider the question of commercial credits. Were our system

such as obtains in countries where commercial paper takes the form of bills accepted by a strong bank, and where an ultimate market for the discounting of paper is found in a central bank, the position would be different, but we have to deal with conditions as they exist, and the extension of the scope of clearing house departments may develop a national system for disseminating credit information supplementary and superior to any afforded by mercantile agencies, or a bank's own research.

It has unfortunately been the case that banks have extended commercial credits largely upon the strength of the borrowers' own unsupported statements coupled with a certain general knowledge on the part of the bank. The fear of losing what has been profitable business may prevent the banker from insisting upon evidence which his own prudence suggests ought to be given. Every banker has at times extended credit beyond what his own judgment would warrant, fearing that his refusal might result in the loss of a valuable account. He decides to take a certain risk in order to retain what has been profitable business.

If, however, the demand for information be made through an examiner, that is, by the clearing house as a body and not by an individual bank, borrowers cannot refuse satisfaction. Time must elapse before the commercial community recognizes and grows accustomed to such requirements, but in the meantime steps can be taken to improve conditions. Copies of all borrowers' statements and other credit information can be filed with the examiner and all new lines of credit opened can be reported to him; comparison of statements with others listed in his files may lead to suspicion of misrepresentation; and there may be in his possession information showing that the borrower contemplated inadvisable loans. In such a case, the examiner may, with the sanction of his committee, instruct the borrower to reduce his operations. By thus eliminating unwholesome bidding for business by the extension of unwarranted credits, much can be done to improve the banking situation.

The experience of Kansas City shows that it is feasible to gather valuable credit data; all large borrowers are indexed and observed, and facts as to their total local obligations are quickly available upon request for any interested member of the association. This, however, is insufficient; the enormous extent of the floating of paper through brokers renders the obligations too widespread for

control by any one association. We must look to further methods, to more stringent demands through the examiner and to co-operation among clearing house associations.

There seems no reason why a clearing house official should not insist upon the evidence of a certificate of certified public accountants; unfortunately, the principle is not yet firmly established of requiring all borrowers to furnish such certificates though the desirability of this is becoming increasingly appreciated. It does not seem too much to hope that in future borrowers shall be required to file with the clearing house examiner such certified statements together with all further evidence of their responsibility, the whole information being confidential with the examiner, but to be imparted by him to any bank interested in the borrower; the examiner being careful to determine the rights of the bank seeking information before this is afforded. The chief point to observe is that insistence upon such evidence of merit in the extension of credit can be effected through a clearing house official with better grace and with more certain results than through an individual bank.

We must look also to co-operation among clearing house associations. Where independent audit has been made and a report is on file with one association, an interchange of courtesies would render this available for all financial centers. The advantages of clearing house examinations and credit bureaus are now so well realized that it seems not unlikely they may shortly be almost universal and the interchange of information with other associations should prove an important feature of the work.

Further, the suggestion has frequently been made that commercial paper be registered. Should this become the general practice, and be made a necessary step in floating paper, it would seem wise that the registrar should be the clearing house of the center in which the head office of the concern is located; and that confidential information be thence afforded to other clearing houses. It is obvious that the organization afforded by clearing house offices of this nature could enormously improve the knowledge of any borrower's standing; the gathering in one credit office of all local information, of all facts learned by other clearing house officers, of records as to registered paper outstanding, and of accountants' reports—these together would afford banks data beyond anything yet acquired through mercantile agencies or through individual

research. In this, exists the germ of a national credit bureau of high efficiency.

What is true of commercial paper is no less true of individual credits and of country-bank or rediscounted paper. Over-trading by a firm or a bank has long been regarded as a menace; the short experience of concerted action by clearing houses has already revealed methods of control.

No remarks upon extension of clearing house functions would be complete without reference to currency associations. Much has been written on the matter and it would be out of place to enter here upon full discussion of so large a subject. One serious objection to our present banking system is the fact that our commercial paper is not a liquid asset; and whilst this fact remains, constant occasions will arise wherein the clearing house must take action. It need only be asserted that it is the duty of our clearing houses to see (1) that steps are taken to insure that arrangements become operative during and not after an emergency; (2) that methods are adopted looking to what may be regarded as a general clearing house for the country as a whole. The pooling of reserves and conversion of paper into liquid assets are insufficient remedies unless made more than local; otherwise we merely have a selfish effort on the part of each center to fortify itself at the expense of other localities.

It would seem possible, by co-operation of clearing houses and the government, to solve this problem of converting commercial paper into liquid assets. The present bond-secured individual national bank currency might be replaced by a uniform currency, and this currency used under proper restrictions in emergencies under joint control of the government and clearing house association. By this means not only would there be a large saving to the government and the banks in the present costly process of the printing and redemption of individual bank currency; but the issuance of a familiar currency in place of an emergency issue of special design in times of stress would tend to preserve confidence. The control of such currency and its method of issue when effected through clearing houses would call for careful attention; but the principal fact to be insisted upon is that it is the duty of our clearing houses to see that so long as our present situation as regards assets and currency remains such as not to operate effectively in time of stress, we shall

at least have ready an emergency remedy. This is a function our clearing houses cannot afford to overlook.

The principle lying at the root of all future clearing house development is that of the unity of interest of all banks. So long as each bank regards all others only as competitors, and makes its own advancement and prosperity the one object to be attained, banking will not reach its highest development and efficiency. Banking is not and ought not to be an occupation merely for its profits. It should be placed on the same basis as other professions; the highest development in medicine or law is attained only when the competitive and money making features are to a certain extent eliminated, and when mutual confidence is shown between the members of the profession. The banking community is an organic whole, no member of which can suffer without detriment to the body. Our progress depends upon a realization of this truth.

THE GROWTH OF STATE BANKS AND TRUST COMPANIES[1]

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One of the most remarkable features of the development of American banking during the past thirty years has been the rapid growth of state banks and trust companies. On May 31, 1882, the last date prior to April 28, 1909,[2] for which complete statistics of the banking institutions of the United States were collected, the number of state banks and trust companies together was less than one-half of the number of national banks, while on April 28, 1909, the number of state banks and trust companies was nearly double the number of national banks. The resources of the two classes of banking institutions have undergone a similar but less marked change in relative amount. On May 31, 1882, the capital of the state banks and trust companies was $116,790,000, and their deposits, in round numbers, $450,000,000, approximately one-fourth of the capital and two-fifths of the deposits of the national banks at the same date, while on April 28, 1909, the capital of the state banks and trust companies was nearly seven-eighths of that of the national banks, and their deposits were somewhat greater.

Even if we separate the state banks and the trust companies, it appears that each class has had a remarkable growth as compared with that of the national banks. State banks and trust companies are not separated in the statistics compiled by the Comptroller of the Currency from the returns made in 1882 by banking institutions to the Commissioner of Internal Revenue. In the same year, however, the Comptroller of the Currency received reports of thirty-

[1] This paper is based on material collected by the writer for the National Monetary Commission, and which will be published more in detail in the publications of the Commission.

[2] The statistics concerning state banks, trust companies and private banks for May 31, 1882, were collected under an act of Congress imposing a tax on the capital and deposits of banks. This law was repealed on March 3, 1883. The statistics for April 28, 1909 were gathered for the National Monetary Commission by the Comptroller of the Currency and the state bank supervisors.

four trust companies with a capital of $22,800,000 and deposits of $165,400,000.

STATE BANKS AND TRUST COMPANIES

	Number.	Capital (in Millions).	Deposits (in Millions).
May 31, 1882, State banks and trust companies.....	1,012	116.79	452
April 28, 1909, State banks ...	11,319	416.06	2,392
April 28, 1909, Trust companies	1,079	362.76	2,812

NATIONAL BANKS

	Number.	Capital (in Millions).	Deposits (in Millions).
July 1, 1882	2,239	477.2	1,131.7
April 28, 1909	6,893	933.9	4,636.47

There is reason to believe that these reports covered practically all the trust companies then engaged in business. The number of state banks in operation in 1882 may therefore be put at 978 with a capital of $94,000,000 and deposits of $286,000,000. On April 28, 1909, there reported to the National Monetary Commission 11,319 state banks with a capital of $416,000,000 and deposits of $2,400,000,000—an increase since 1882 in number of some 10,400 banks, in capital of $320,000,000, and in deposits of $2,100,000,000. During the same period the increase of national banks in number was 4,654, in capital, $460,000,000, and in deposits, $3,500,000,000. It will be noted that the increase of the state banks in number was more than double that of the national banks, but the increase in capital and in deposits was only about two-thirds of that of the national banks. In all three respects, however, the percentage of increase was much greater for the state banks.

INCREASE FROM 1882 TO 1909

	State Banks.	Trust Companies.	National Banks.
Number	10,341	1,045	4,654
Capital	$322,000,000	$340,000,000	$456,000,000
Deposits	2,114,000,000	2,647,000,000	3,505,000,000

The increase of the trust companies from 1882 to 1909 in number was 1,045, in capital, $340,000,000, and in deposits, $2,647,000,000. The increase of the trust companies in all three respects was less than that of the national banks, but in capital and deposits it was approximately three-fourths of that of the national banks.

The percentage of increase was enormously greater in all items than that of the national banks.

Both for the state banks and the trust companies, this increase has been by no means equally distributed over the whole period since 1882. The number of state banks showed little increase until 1886. From 1,207 in that year, it rose until in 1893 it amounted to 3,700. From 1893 until 1898, the increase was very small, the number standing at 4,062 in 1898. The period from 1898 to 1909 was marked by a prodigious increase in the number of state banks. From 4,062 in 1898 the number rose by 1909 to 11,319—an increase of over 7,000 banks and of 179 per cent. The capital of the 3,965 state banks—ninety-eight per cent of the total number in operation—whose reports were compiled by the Comptroller of the Currency in 1898 was $233,600,000, and their deposits were $900,000,000; while in 1909 the capital of the 11,319 state banks, whose reports were compiled by the National Monetary Commission, as has been noted above, was $416,000,000, and their deposits $2,392,000,000—an increase in capital of seventy-eight per cent, and in deposits of 166 per cent.

INCREASE FROM 1898 TO 1909.

	STATE BANKS.		TRUST COMPANIES.		NATIONAL BANKS.	
	Absolute Increase.	Percentage of Increase.	Absolute Increase.	Percentage of Increase.	Absolute Increase.	Percentage of Increase.
Number	7,257	179	679	170	3,299	92
Capital	$182,400,000	78	$202,000,000	126	$304,000,000	48
Deposits	1,492,000,000	166	1,700,000,000	155	2,636,000,000	132

The period from 1898 to 1909 was also, without question, the period of greatest increase in the number and resources of the trust companies. The statistics of the trust companies cannot, however, be exactly ascertained for 1898. In that year, according to the report of the Comptroller of the Currency, there were 246 trust companies, with a capital of $101,000,000 and with deposits exclusive of bankers' deposits, of $662,000,000. The reports of trust companies in the Comptroller's report for 1898 were, however, incomplete, and it may be estimated from the unofficial reports in the bankers' directories that the number of trust companies was

about 400, and that their capital was $160,000,000, and their deposits $1,100,000,000. According to the reports made to the National Monetary Commission, on April 28, 1909, nearly 1,100 trust companies were actively engaged in business and, as has been noted above, these trust companies had a capital of $362,000,000, and deposits of $2,800,000,000, an increase of 170 per cent in number, 126 per cent in capital, and 155 per cent in deposits.

The national banks experienced also a rapid increase both in number and in resources during the same period. On February 18, 1898, the number of national banks was 3,594, with capital of $629,000,000, and deposits, exclusive of bankers' deposits, of $2,000,000,000. On April 28, 1909, the number of national banks was 6,893, with capital of $933,000,000, and deposits, exclusive of bankers' deposits, of $4,636,000,000, an increase in number of ninety-two per cent, in capital of forty-eight per cent, and in deposits of 132 per cent. It will be noted that in none of these respects was the rate of increase as great as in that for the state banks or the trust companies.

In considering the causes of the remarkable growth of state banks and trust companies outlined above, it will be desirable to consider separately the two classes of banking institutions, although, as will be pointed out in detail later, the state banks and trust companies are in certain important respects practically a single class.

State Banks.—Since private and national banks as well as state banks are banks of discount and deposit, the disproportionate increase of state banks noted above must be explained by their superior advantages over one or both of the classes competing with them. It must be noted, however, that the national and private banks have almost exclusive fields of operation, for very few private banks have a capital sufficiently large to enable them to organize under the national bank act.[3] The state bank, on the contrary, is a rival of both the private and the national bank, since the amount of capital required in most of the states to incorporate

[3]The 1,497 private banks which reported to the National Monetary Commission on April 28, 1909, had a capital of $27,000,000, or an average capital of $18,036. Of the 385 private banks, whose capital for the year 1909 is reported in the official state reports, 232 had a capital of less than $15,000 and only 72 had a capital of as much as $25,000. Until the passage of the act of March 14, 1900 the smallest permissible capital for a national bank was $50,000, and since then it has been $25,000.

a bank under the state banking laws is small enough to make it possible for private banks to become incorporated if they desire to do so. The causes which have led to the increase of state banks may, therefore, be divided into two categories according as they have been influential in giving the state bank an advantage over the private or over the national bank.

Private banks fulfil in the American banking system two distinct functions,—first, as an adjunct of the brokerage business in the large cities, and second, as a means of furnishing credit in small communities chiefly in agricultural sections. It is in the latter of these capacities that the small state banks compete with the private banks.

The number of private banks increased very rapidly from 1877, the earliest date for which complete data are accessible, to 1888. In 1877 there were 2,432 private banks in the United States and by 1888 the number had increased to 4,064. Since 1888 the increase in the number of private banks has been very small. In 1909 only 4,407 such banks were reported by the bankers' directories. This check to the increase in the number of private banks has come about despite the constant increase in the number of brokers' banks. If the number of private banks in the states of New York, Massachusetts, Pennsylvania and Illinois, in which the great mass of private banks are brokers' banks, are deducted from the total number of private banks the remaining number is less in 1909 than it was in 1888. It appears probable that the number of private banks in the United States apart from the brokers' banks is not at the present time more than one-half of the number in 1888.

During the same period, the number of small state banks has increased with great rapidity. In 1888 the number of state banks with less than $50,000 capital was 747, while in 1909 the number of state banks with a capital of less than $50,000 was 8,980, and the number of state banks with a capital of less than $25,000 was 5,878. Approximately one-half of the state banks in operation in 1909 had a smaller capital than that required for the organization of a bank under the national bank act.

This rapid increase in the number of small state banks is to be explained partly by the fact that depositors prefer to deal with incorporated banks. The development of the state banking laws since 1888 has given the state bank in most of the states superior

credit to that possessed by the private banks. In a few states, the lowering of the amount of capital required for the incorporation of state banks has been responsible for the greater relative growth of small state banks.

Another factor of importance in the displacement of the private bank by the small state bank has been the increasing number of laws regulating in one way or another the conduct of business by private banks. These provisions vary widely in the different states. In some private banks are forbidden to use a corporate name. In others they are required to use on their signs and advertising matter the words "private" or "unincorporated." In a third group of states, private banks may not use the word "bank" on their signs or advertisements. In a fourth group, an attempt has been made to subject the private bank to the same supervision and regulation as the state bank. This attempt has not on the whole met with great success. The essential feature in the regulation of banks, both under the national bank act and under the state banking laws, is the requirement that banks shall have a specified minimum capital. This capital is regarded as a buffer between the losses which the bank may suffer and the deposits of the bank. In a number of states private banks are required at present to have a capital stock, but this provision does not yield satisfactory results, since the banker may engage in other enterprises, and may thus incur an indebtedness which may fall upon the assets of the bank. In a few states an attempt has been made to meet this difficulty by providing that the depositors of the bank shall have a first lien on the assets in case of the insolvency of the owner. A half dozen states have gone even further and have prohibited individuals from carrying on the business of banking. The result of these provisions, taken as a whole, has been to induce or compel many persons about to engage in the business of banking to incorporate under the state banking laws rather than to engage in the business as an individual or as a firm.

Apparently the development of state banking regulation has given a great stimulus to the growth of small banks. The period from 1899 to 1909 was marked by a greater increase in the number of banks than any other period of similar length in the history of the United States. The number of national and state banks increased from 7,763 in 1899 to 18,212 in 1909. A very large part

of this increase, both of national and state banks, was of banks with less than $50,000 capital. From 1899 to 1909, the number of state banks with a capital of less than $50,000 increased from 2,529 to 8,980. Until 1900 national banks were not incorporated with a smaller capital than $50,000. On September 1, 1909, there were in operation 2,197 national banks with a smaller capital than $50,000. Of the total increase of 10,449 in the number of national and state banks from 1899 to 1909, 8,548 were banks of less than $50,000. The period from 1899 to 1909 was marked, therefore, in the banking history of the United States pre-eminently by the increase in the number of small banks. In this development the national banking system has shared to some extent through the amendments made to the national bank act by the act of March 14, 1900, but a very large part of the increase in the number of small banks was of banks of less than $25,000 capital.

The following table shows the number, in 1909, of state banks of less than $25,000 capital classified according to capital:

Capital	Number
$5,000 or less	414
Over $5,000, less than $10,000	240
$10,000, less than $15,000	3,029
$15,000, less than $20,000	1,420
$20,000, less than $25,000	775

These banks are by no means evenly distributed among the various states. The following table shows the number of banks of less than $25,000 capital by groups of states:

New England	0
Eastern States	36
Southern States	1,786
Middle Western	1,596
Western States	2,255
Pacific States	205

It will be noted that such banks are numerous in the Southern, Middle Western, Western, and Pacific states. The entire absence of such banks in the New England states and the small number of them in the Eastern states is partly to be accounted for by the fact that, in some of these states, state banks are not chartered and in others the amount of capital required is large, but the chief

reason is that the economic conditions in these sections do not make such banks profitable. The greatest development of such banks is found in the more sparsely settled agricultural districts.

The growth of large state banks (*i. e.* banks with a capital sufficiently large to enable them to incorporate under the national bank act), while by no means so striking as that of the small state banks, presents, when compared with the growth of the national banks, significant and noteworthy features. In 1877 the number of state banks with a capital of $50,000 and over was 634, and the number of national banks was 2,080.* In 1909 there were in operation 2,610 state banks with a capital of $50,000 and over and 4,773 national banks with the same amount of capital. The absolute increase in the number of the state banks of this class has been somewhat less than the increase in the number of national banks, but the percentage of increase has been very much greater; moreover, since 1888 the absolute increase in number of the state banks of this class has been practically the same as that of the national banks.

The more rapid growth of the state banks of this class than of the national banks appears to be due chiefly to two advantages:

In the first place, the state banks in practically all of the states have the power to loan on real estate, and, as is well known, the national banks do not possess this power. All banks, however, are not equally desirous of having power to loan on real estate. The banks in the larger cities and towns do not ordinarily care to loan largely, if at all, on real estate, since they can occupy their funds fully in local commercial loans. Also the banks in the more newly settled parts of the country ordinarily prefer not to loan on real estate since the value of land in such sections is not stable. The desire to loan on real estate is greatest, therefore, among the banks located in the smaller places in those sections where the value of agricultural land is most stable.

Secondly, the reserve requirements in the state banking laws in one way or another are far more liberal than the requirements under the national bank act. In a large number of the states, banks either are not required to hold a reserve against savings and time deposits, or the reserve which must be held against such deposits is

* Since the passage of the act of March 14, 1900, national banks may be incorporated with a capital of $25,000. For the relative importance of state and national banks with a capital of $25,000 and less than $50,000, see p. 144.

very small. Also in those states which require the same reserve against all deposits the reserve is usually lower than that required by the national bank act. Such provisions are particularly advantageous to those banks which have a considerable amount of time and savings deposits, since the national banks are required to carry the same reserve against demand, time and savings deposits.

On the other hand, there are certain advantages in incorporation under the national bank act. The chief of these are the superior credit of the national bank and the profit to be made on note issue. For many years after the Civil War, the national banks were practically the only incorporated banks of discount and deposit in many of the states. It was well known that these banks were supervised and regulated. State banks, on the contrary, until quite recently in most of the states were under no supervision and were incorporated on practically the same terms as manufacturing, mining and other ordinary corporations. The national banks came, therefore, to have a much higher standing with depositors than the state banks. In recent years, with the development of the state banking systems, the state banks, in many of the states, have come to have almost, if not quite, as high a standing as the national banks. In so far, however, as the business of a bank is with persons or banks in other states, the national bank has an advantage over the state bank, since the residents of one state are ordinarily not acquainted with the provisions of the banking laws of another state, while they know the general character of the provisions of the national bank act.

This advantage is greater for the larger banks than for the small ones, since the smaller banks have relatively less business with persons or banks in other states. The wider credit of the national bank is a particularly important consideration to the promoters of banks in the newly settled states who wish to sell stock to residents of other states, since it is much easier to secure the investment by non-residents in the stock of a national bank than in the stock of a state bank.

The second chief advantage in incorporation under the national bank act is that a certain amount of profit may be obtained from note issue. It was the large profit to be obtained from the issue of notes which in 1865 and the years immediately succeeding induced the great mass of state banks to incorporate under the

national bank act. The increasing price of United States bonds led, however, by 1880 to a great reduction in the profit on bank note circulation and, as a consequence, from 1882 to 1891 the circulation fell off rapidly. A decline in the price of bonds caused a slow increase from 1891 to 1899. Since the passage of the act of March 14, 1900, the profit on note issue has been larger and a great increase in the circulation has resulted. The profit at present, however, is by no means equal to the great profits which caused the conversion of the state into national banks in the period from 1865 to 1870. As estimated by the Comptroller of the Currency the profit on note issues in October, 1909, was 1,334 per cent in excess of six per cent on the investment. A bank with a capital of $100,000 may secure a maximum profit of $1,334 from a note issue.

Some of the factors noted above vary in strength according to the size of the place in which the bank is located, according to the economic development of the section of the country, or, finally, according to the class of business which any particular bank wishes to do. But certain general conclusions as to their net result may be drawn.

In the first place, the net advantages of incorporation under the state banking laws are relatively greater for banks of small capital than for those of large capital. The following table shows the number of state and national banks in operation in 1909 with a capital of $25,000 and over, classified according to capital:

Capitalization.	Number of National Banks.	Number of State Banks.
$25,000, less than $50,000	2,197	3,102
$50,000, less than $100,000	2,214	1,549
$100,000 and over	2,559	1,061

It will be noted that the number of state banks with a capital of $25,000, and less than $50,000, is much larger than the number of national banks with the same capital; but that in the class of banks with a capital of $50,000, and less than $100,000, the national banks are the more numerous. The number of national banks with a capital of $100,000 and over is two and a half times the number of state banks of the same capital. Only 203 of the state banks in operation in 1909 had a capital as large as $200,000, while 652 of the national banks had a capital of $250,000 and over.

In the second place, as is shown in the following table, the number of large state banks, i. e., state banks with a capital of $25,000 and over, in operation in 1909, is much greater relatively to the number of national banks in some sections of the country than in others:

	Number of National Banks with a Capital of $25,000 and over.	Number of State Banks with a Capital of $25,000 and over.
New England States	484	19
Eastern States	1,567	410
Southern States	1,406	1,822
Middle Western States	1,997	2,154
Western States	1,121	616
Pacific States	395	681

It will be noted that the number of state banks of this class is larger than the number of national banks in the Southern, Middle Western, and Pacific states, and that the number of state banks of this class is very small in the New England states and much less than the number of national banks in the Eastern and Western states.

Trust Companies.—In any consideration of the causes responsible for the great growth of trust companies in recent years, it must be borne in mind that a very large number of the so-called trust companies either entirely lack the power to engage in a trust business or have not cared to use this power. In Massachusetts, for example, a state in which a notable development of trust companies has occurred within the past twenty years, no state banks have been incorporated for many years, and a very large number of the trust companies do only a banking business. In fact, a trust company in Massachusetts, before it may act as a trustee, must be specially authorized by certain state officials. Of the forty-eight trust companies in business in Massachusetts on November 16, 1909, only twenty-six had trust departments. Similarly in Maine and Vermont no state banks have been incorporated in recent years and many of the so-called trust companies are state banks in all except name.

Even in several of those states where both state banks and trust companies are incorporated the preference for organization under the trust company law is not due chiefly or largely to the desire

to carry on a banking and trust business in combination, but to the greater liberality of the trust company law in its regulation of the banking business. Despite the fact that there has been for some years a gradual assimilation of the regulations relating to the two classes of institutions, in many of the states the regulations relating to the banking business of the trust companies are less restrictive than those relating to the state banks. In New York, for example, where the increase of trust companies in number and resources in the past ten years has been much larger than that of either the national or state banks, there is no doubt that the more liberal reserve requirement for the trust companies has been a factor of considerable importance in their growth. It is noteworthy that the great increase in the number of trust companies has occurred in comparatively few states, notably in the New England states, New York, Pennsylvania and Indiana. In some of these states, state banks, as has been noted, are not incorporated, and in others there are significant differences in the regulations to which state banks and trust companies are subjected.

It cannot be doubted, however, that there is for many banking institutions a distinct advantage in combining the trust and the banking business and that this has been a factor of great importance in the growth of trust companies. The growth of the various forms of trust business will be the chief factor in the future increase of these companies since, as has been noted above, in practically all the states there is a growing disposition to assimilate the regulations of the banking business whether carried on by a trust company or a bank.

Since many so-called trust companies are state banks except in name, and since in many of the states the trust companies are to all intents and purposes not a distinctive class of banking institution but merely state banks which may engage also in a trust business, in order to measure fully the growth of state banking, it may be worth while to combine the numbers of the two classes of institutions. Since, however, the trust companies are usually of large capital, it will be sufficient to consider the result obtained by combining the number of state banks and trust companies with a capital of $100,000 and over.

There were in the United States in 1909, 1,781 state banks and trust companies with a capital of $100,000 and over, and 2,559

national banks of the same capital. The trust companies and the state banks of this class are more numerous than the national banks only in the Pacific Group. In the Eastern states, however, the disparity in numbers is not great. The smallest number of state banks and trust companies compared with the national banks in this class is found in the New England and Western states. In neither of these groups is the number of state banks and trust companies with a capital of $100,000, and over more than one-third of the number of national banks of the same class.

BRANCH BANKING AMONG THE STATE BANKS

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At the 1910 convention of the Alabama Bankers' Association, held in Birmingham in May, one of the speakers, whose topic was "State Banks and Their Branches," closed a condemnatory address with the words: "We believe the days of the branch bank are numbered." Two months later, at Cooperstown, Hon. E. B. Vreeland told the bankers of New York State, at their convention: "No one will ever live to see the day when the branch banking system which prevails in Canada and in Germany and in England and in France will be tolerated by the people of the United States."

I am sure that there are a considerable number of people in the various states whose opinions differ from those of the authorities I have quoted. Those who have closely followed the course of banking affairs must have noticed that the branch bank idea has made respectable progress. As is always the case when a reform struggles with hostile laws and against the opposition of established interests, it finds expression in a variety of ways. Thus, some bankers who desired to bring a number of banking institutions into cohesion have sought to attain their ends through purchasing the stock of other banks and controlling them through stock ownership. There are some cases wherein a practical banker has had himself elected or appointed to the presidency or management of a group of banks in a certain state or territory without his owning a majority of the shares of the several units. Then, the holding company method has been employed in some instances; and in a number of states small branch banks are operated under a sort of grudging toleration from the legislatures. It can be said that nowhere in the country are the branch institutions suffered to develop all the functions which they should exercise in order to attain their highest usefulness; nowhere is a branch bank allowed to develop to the dimensions that would fit it for taking care of a large part of the commerce and industry of a state or geographical division.

In his address to the New York State bankers, from which I

have already quoted, Hon. Mr. Vreeland said further: "The economies of the branch banking system are such that no other system can live beside it. It is just as sure as the sun will rise to-morrow that the branch banking system, if taken up in the United States, would in the end drive out of existence all the banks in every city and town in the country outside of the great financial centers. That is the experience of the world."

If this statement means anything it is a confession that the system of local single-office banks is wasteful in operation, and it seems to me that it sets forth one reason why branch banks are inevitable. When a banking system is wasteful it is the stockholders, borrowers and depositors who suffer from the circumstance, and as soon as they realize the fact its doom is sealed.

It should be said here that it is not their economical operation alone that has enabled the branch banks to displace the small local banks in England, Germany and France. The branch institutions are cleaner, more efficient, and they provide better opportunities for the clerks and officers; they give a better and more complete service to the localities in which they work. To illustrate this latter statement, I give the following comparison: In the United States at the present time it is not difficult to find cases like the following: There will be a town of say 2,500 or 3,000 people which has a little national bank or perhaps two of them. Surrounding this town at distances ranging from three to twenty miles are seven or eight small villages, the largest of which may have 1,000 or 1,200 population. Not one of these small places has a bank. The banks in the larger place at the center draw deposits from them all and perhaps do some discounting for a few of the principal business men in the outlying villages. Also, in the large town are a few manufacturing concerns which cannot get all the accommodation they need from the two local banks because the banks are too small. Consequently they are forced to borrow in New York or Boston.

If that locality were served by branch banks of the Canadian pattern there would be in the central town branches of perhaps three large institutions; and five or six of the outlying villages would be provided with branches or sub-branches. The manufacturers would borrow at home; they would not be compelled to go to New York or Boston. Everybody in any of these places, and the prosperous farmers in the tributary districts who possessed good char-

acter and a respectable standing, could borrow for legitimate needs. The country people would have excellent facilities for depositing in banks that had their confidence.

So it is because of the combination of economical operation and the provision of superior facilities, that the branch banks have crowded out the local banks in other countries. Another reason is found in their stability during crises. The stage coach has been superseded by the steam railway in America; and it is quite likely that for the very same reasons the local banks will in the course of time be obliged to give place to branch institutions. When the bankers get a clearer idea of the advantages that will accrue to them through the conversion of their single-office banks into branches, and when the people get a better conception of what properly constituted branch banks would do for them it is to be expected that progress in that direction will be accelerated.

In the meantime it is worth while to take note of the progress that has been made. Now it should be observed that mere size counts for much in the operation of branch banks. Large figures give prestige, and a widely spread system of branches makes for stability when the central administration is good. The different industries which the banks finance are not confined within the borders of particular states; and branch banking will never give the best account of itself while the operations of each bank are circumscribed by the boundaries of a particular state, no matter how large and populous the state may be.

However, we find that the federal laws are almost prohibitive. A newly organized national bank may not establish branches. In his article which appeared in the "Financier" of May 28th, 1910, Mr. W. J. Fowler, Deputy Comptroller of the Currency, says: "The operation of a branch by a national bank of primary organization, while not prohibited in expressed terms, is prohibited by implication, and the courts have held that what is implied is as effective as that which is expressed." When a state bank which operates branches is converted into a national bank it may continue to operate its branches under the national system, but presumably it may not open new branches or extend itself further in that manner. Mr. Fowler states that up to and including July 23d, 1908, there were but four instances of state banks with branches converting themselves into national banks and continuing to operate the branches.

The first conversion was on March 14th, 1907. It was that of a bank in Mississippi with $75,000 capital and one branch. The second state bank to convert also belonged to Mississippi. It had $50,000 capital and one branch. Conversion took place on May 31st, 1907; the branch was discontinued on February 6th, 1909, and the concern was placed in voluntary liquidation on April 1st, 1910. A third Mississippi state bank with $50,000 capital and one branch was converted on February 21st, 1908. The fourth conversion was that of an Oregon institution with capital of $50,000 and one branch. It occurred on July 23d, 1908.

On February 5th, 1910, the Bank of California, with capital of $4,000,000 and four branches, was converted into a national bank. This is the first instance of a branch bank of real importance operating under the national laws; and its course will be watched with great interest. Its capital and resources are large enough to give it prestige throughout the whole Pacific coast. If it and other banks were but permitted to open branches where they pleased and were suffered to operate them without being subjected to harassing taxes, prohibitions and restrictions, it is practically certain that they would rapidly enlarge their capitals and extend into hundreds of small places. The business men and small borrowers in those places might then expect to get accommodation at rates perhaps two-thirds as high as they at present pay to private banks and other small local institutions.

Among the state banks operating branches the Corn Exchange of New York occupies a prominent place. The New York State laws are not favorable to branch banking. Taxation is high and the stipulation that $100,000 capital shall be allotted to each branch is irksome. In other countries where the branch system is authorized and supported by the laws it is not attempted to regulate the capitalization of the branches. It would be impossible to do so. The balance due by the branch to the parent bank, or that due by the parent bank to the branch, fluctuates constantly in response to the operations of the bank's customers. Thus an important borrower at the branch may discount $300,000 worth of paper, and upon completing the advance the branch will owe head-office on balance $250,000. Then in due course the loan is paid off and some special deposits are received, with the result of throwing the balance on the other side—head-office may owe the branch $200,000. There

are many quiet localities where there is practically no demand for loans on discounts and where deposits constitute almost the whole business of the bank. For example, in a rich Eastern agricultural district a branch might have $600,000 or more deposits, and it may not be able to lend more than $50,000, no matter how earnestly the manager seeks for good borrowers. To force the parent bank to provide $100,000 capital for a branch of this type is an economic blunder. The branch already has over half a million of capital which it cannot use at home. When legislators pass laws of this kind they have in their minds the idea that the branch banks are merely contrivances for drawing the resources of the interior localities to the financial centers. So they create a set of conditions under which it is next to impossible for the banks to give good facilities to small places. It would be a wiser policy to encourage the establishment of sound banks in very small places and to supervise their head-offices so as to ensure that they provide properly and satisfactorily for the financial needs of the localities served by their branches. There are no means, other than through branch banks, of providing satisfactory facilities for small places. Doubtless because of the uncongeniality of the laws the Corn Exchange Bank has not spread its branches into the country districts. Its score of offices are found in the various districts of New York city.

Considerable interest attaches to the chain of one hundred or more state banks in Georgia which are combined under the one presidency. Apparently these institutions are held together merely by the fact that they have a common president. They represent what might be styled a banking federation. Each unit preserves its separate identity; and if the president were to resign or die presumably the federation might break up. There is in this arrangement a certain degree of cohesion between the parts, and it should be possible to transpose or transfer surplus funds from one part of the system to another when the occasion for doing so arose, just as the funds of a branch bank are thrown from one end of the system to the other in response to the demands of the industries and trades financed by the bank. But the tie in the Georgia case is personal. It is an instance of the one-man-power which is far too common in United States banking. In Canada it is the bank, and not the local manager, the general manager, or the president, that commands the fealty of the men. The bank has its history and traditions extending

back for fifty, sixty, or eighty years. The managers and presidents succeed each other while the bank grows and develops, spreading itself gradually into all the provinces and abroad into foreign countries. This great impersonal thing—the bank—is what the men serve. The best of them watch its progress from month to month and glory in its greatness.

So the Georgia aggregation can hardly be regarded as a branch bank. It is interesting, however, as an illustration of one method by which the branch bank idea is finding expression under discouraging laws. Last year in his annual report the Wisconsin Bank Commissioner registered a vigorous protest against the operations of a holding company in Minneapolis which had, he said, acquired control of more than forty banks in Wisconsin, Minnesota, and the Dakotas. One ground of objection was that these controlled banks proceeded to lend their funds to parties outside the state in which they were located. Of course there are serious objections to this method of doing business. But it is merely another illustration of how an irresistible force will break through or circumvent hostile laws. In the railroad and industrial worlds, capital has been allowed to concentrate itself and then, by means of agencies and branches, to diffuse its operations over huge territories. In time banking must be suffered to take the same course if the customers of the banks in the United States are to have the same advantages that bank customers in other countries enjoy.

Though it is objectionable in some respects, the Minneapolis holding company plan is preferable to that wherein one individual proceeds to acquire control over a number of banking institutions through purchasing a majority of the stock. There are two sets or cliques of great financiers in New York City credited with possessing control of chains of important banks in their own city and outside. When practised by financiers of a different grade, this method of concentrating banking capital may do considerable damage. Thus the activities of the Heinze-Morse group of financiers in acquiring control of other banks had something to do in precipitating the 1907 panic. Chains of banks formed after this fashion have no resemblance to properly constituted branch banks. Sometimes the financiers who form them do so with the object of enlarging the scope of their own borrowings. While the separate entity of each institution is preserved, there is no economy of administration and

operation such as is secured under the branch system. It merely means the extension of the domination of an individual or a set of individuals over a number of institutions, and the influence in question may often enough be of an undesirable or evil character.

In studying the banking development of the Western states one meets several phases of this process of individuals acquiring chains of banks. But in the West they call them strings rather than chains. Thus a news item may state that so and so of Blankville has bought a string of banks in the northern part of the state. This gives the idea that the transaction was somewhat similar to one involving the purchase of a drove of cattle or a number of barns and stables. Needless to say, such an aggregation of banks would not bear the slightest resemblance to the great branch banks of Canada, England, France, or Germany; and their operations cannot properly be regarded as branch banking among the state banks.

We now come to the consideration of the small branch institutions operating in a number of the states, which have very moderate capitals and only a few branches. In many cases these should be designated as local banks rather than branch banks; but, speaking technically, if a little concern of this description operates but one branch, it becomes a branch bank. Some of them appear to have been weak, struggling affairs which established one or two branches in near-by towns in the hope that the branches might be able to supply the parent bank with enough new deposit money to permit it to meet its obligations. Sometimes these so-called branch banks fail, and ruin and disaster come upon the hapless creditors who trusted them. These accidents also serve to bring branch banking into disrepute. The State of Alabama recently had some unpleasant experiences which led the president of the Bankers' Association to say:

> It is with regret that I report that, growing out of the failure to carry out and enact into law the resolutions passed at Mobile, we have had a chain of bank failures in Alabama. Several Alabama communities have lost the savings of a lifetime . . . and all the banks have come more or less under suspicion. Your able ex-president, W. P. G. Harding, in his annual address at Mobile, said in substance: "While we have in this state some notable examples of the successful operation of branch banks, it appears that their success has been due entirely to the excellent character of the

management, and it seems imperative that we should have a law in Alabama regulating the establishment of branch banks in the future."

For all those who are interested in this subject of branch banking among the state banks, the report of proceedings of the Alabama bankers' 1910 meeting, as given in the New York "Financier," contains valuable data. I have not seen the question so exhaustively discussed in any other convention report. Although the Birmingham convention recorded itself in a condemnatory manner towards branch banking—probably for the reason that many of the examples of branch operation coming under the immediate observation of the members had not been calculated to win their admiration or respect—the arguments were not all turned in the one direction. Mr. S. S. Broadus, President of the Tennessee Valley Bank, gave a comprehensive and instructive description of the evolution of a single-office bank into a branch concern operating twelve offices. He related how he spent the year 1891 in the office of the Louisville Banking Company "studying how a great city bank is managed." Graduating from this school, he opened, in 1892, in Florence under the name of the Merchants Bank, and conducted the institution as a single-office bank for five years. In 1897 a branch was established at Tuscumbia, a county seat; then at Scottsboro, another county seat, and at intervals of a little over a year successive new branches were added to the system until in 1910 there were twelve branches besides the head or parent office. In 1908, the name of the bank was changed to Tennessee Valley Bank. The head office had been transferred from Florence to Decatur in 1904. The capital is $200,000. The following is said to have been the policy adopted in establishing branches:

In locating our branch points I have never gone to places already having sufficient banking facilities, but generally to smaller points entirely lacking such. As a matter of fact, of our thirteen points not half of them could permanently sustain a small independent bank, while a branch of our large strong bank can take excellent care of the banking needs of a small community, which at the same time is a desirable part of the business as a whole.

Mr. Broadus' characterization of his $200,000 institution as "a large, strong bank" will perhaps bring a smile to the faces of bankers and others accustomed to the Canadian branch banks with capitals ranging from $2,000,000 to $14,000,000 and branch systems com-

prising from fifty to two hundred offices. But he means doubtless that his bank is large in comparison with the local institutions which it meets competitively in the small places of the Tennessee Valley.

In regard to stockholding, the management has aimed at having desirable business men at each branch point purchase a small interest in the institution; but a large holding by any one interest is not encouraged. To quote the president: "There is but the one corporation with stock in it owned by selected persons at our various points, some owning only one or two shares and seldom any more than ten. Then, at each point it is endeavored to have, from among the local shareholders, not less than one director." This latter policy would not be practicable in the case of a bank with numerous branches. For either the directors would be so merely in name, or the benefits attendant upon concentration of management would be largely lost.

One of the differences between branch banking and local banking is seen at once when the question of an office building comes up. Mr. Broadus says: "In opening a small branch bank I have always borne in mind that the influence of the local shareholders will naturally tend towards an expensive building 'to help the town.' For instance, they always urge a two-story building at least." If the bank is to be a commercial success its managers must fight against extravagance and waste just as the managers of other commercial ventures are obliged to do. The commercial and industrial development of a small locality is not usually permanently promoted by the erection there of a bank building more expensive than the bank can afford.

The staff is selected from country villages and no young men are employed who ever worked in a bank, because of the president's wish that they shall get their methods and inspiration from him. It is worth while noting here that the large Canadian branch banks draw their recruits to a large extent from country villages. They enter the bank at the age of seventeen or thereabouts and are trained in the bank's system and methods. The Canadian banks also import many youths from Scotland and England, because they cannot get enough juniors in Canada. They bring over juniors who are started at say $250 per year, and ledger men and clerks, not over twenty-three or twenty-four, with experience in bank work, and give them

$600 or $700. Both classes get regular increase of salary every year.

In the case of a small branch of a state bank it appears that the office will probably be started with but one man, and he perhaps taking charge fresh from his duties as clerk in a country store. In Canada no branches are started with less than two men, as the banks consider it absolutely necessary to have present in the office an employee other than the manager to serve as a check upon him.

The following account tells something of the method of reporting to head office used by the branches of the Tennessee Valley Bank, and it can perhaps be taken as applying to other well-conducted branch banks operating in country districts under state control:

> With the exception of a journal at each point, our books of original entry are put up in impression copy pads or in penwriter form. For instance, after the daily check and deposit record has been written up in full, the individual entries posted to the individual ledger, and the totals to the general ledger, the original sheets are carefully copied into an impression book, and then mailed to me at Decatur, reaching my desk next morning. Similarly as to a discount sheet at each branch point, this sheet showing any loans made during the day. A penwriter sheet sent daily to Decatur gives the items of all exchange drawn and all remittances made, and a daily balance with the branch.

An experienced banker will read between the lines here that these branches do not enjoy an extensive scope or freedom of action. The system would be in a better way of becoming popular throughout the country if the branch managers were trained men and possessed a larger degree of independence. It is one of the peculiarities of banking in the United States that a large numbr of bankers believe that a store clerk may be just as efficient as a branch manager as a trained professional would be and that a successful storekeeper, merchant, or manufacturer can undertake the active management of a bank as well as any other. Those ideas do not hold in the Dominion. There, banking is treated as a profession, and everybody who practises must pass through the various stages of a thorough education.

Under the Canadian system the branch managers are all trained men; also the local manager has a more dignified status in regard

to the matter of lending the bank's money. This is one of the most interesting parts of the whole subject. It is commonly urged by the opponents of branch banking that it is obnoxious to the business men of any locality to have their applications for loans passed upon by a far-away authority; and that the branch banks take the deposit money of the locality and send it away for use at other points, refusing to lend freely to local borrowers. In view of this argument it is interesting to observe what Mr. Broadus says about the practice of his bank. Under the heading "Making Loans," he remarks: "At first there is not much lending at our branch points, and at first it is all passed on by me. Later on small loans for less than $100 are made at our branch points without consulting me, such of course generally having more than one good signature or endorsement. In addition to small loans our branches make somewhat larger loans, but only along lines and to persons carefully considered and understood between our Decatur office and the branches. All of the more important lending is passed upon by me beforehand, the notes being run through at Decatur, even if it be but for $10 and only until pay day. . . . Our re-discounting during the summer time is altogether handled by our Decatur office, and is of course facilitated by our having the more important notes run through at Decatur as stated."

There is a wide difference between the operations of a branch of this kind and those of a newly opened office of a large Canadian bank. The Canadian manager starts to lend and discount at once. In fact that is the main part of his business except in the little towns and villages in quiet agricultural districts in Eastern Canada. The matter of the bank's having funds to lend for the regular business of local borrowers does not trouble him at all, scarcely even during periods of stringency. The only things he concerns himself about are the solvency and reliability of the borrower and the legitimacy of the transaction in which the bank's money is to be embarked. Provided the term of the loan is short, the manager of a good bank in a small place acts on his own responsibility in lending up to say $1,000. At a larger branch he would lend up to a higher figure. A credit of $1,000 covers fairly well all the requirements of the less important traders at a country village. For amounts exceeding that sum credits are applied for; and if the applicant is in a satisfactory position head-office will authorize the local manager

to take his paper up to an agreed-upon maximum, subject to certain rules and stipulations. Then the discounted paper is invariably held by the branch itself—if it is payable locally, and the Canadian banks do not rediscount. So if a borrower in a Canadian village goes to his bank with $500 to pay off his note a month ahead of its maturity the manager can always produce the note on the instant from the bill case. He does not have to ask the man to wait till he can get it back from head-office.

Deposits are a secondary consideration. Of course all branches strive to build up their deposit balances, as the deposits constitute the main source whence the funds for lending are derived. But the energies of the branch manager are mainly directed towards the acquisition of desirable discount accounts; and the bulk of the correspondence with head-office pertains to that department of the bank's business. It is found also that a policy of this kind results incidentally in the quickest development and growth of deposits. That is to say a branch that provides fully for the borrowing needs of the community in which it is located, at moderate rates, will usually be much more successful in building up its deposits than it would be if it starved the local borrowers and tried to develop the deposit department only.

In times of great stringency the regular customers of the branch get their credits from head-office very much as usual, but they are required to keep their borrowings within as small a compass as possible, and are discouraged from embarking in new ventures or extensions necessitating borrowed money. Also the branch manager is asked to refrain from canvassing or campaigning for important new discount accounts until the money situation relaxes.

From these remarks, it can be seen that branch banking as practised among the state banks is on a different basis from that prevailing in the Dominion. Except for one or two isolated examples it might almost be said that in the United States branch banking as it is understood in other countries is as yet scarcely existent. Under more favorable laws it would develop with surpassing rapidity; and it is quite probable that under the existing laws those branch banks which are now carefully and wisely developing themselves will evolve into institutions that will compare satisfactorily, in point of efficiency and usefulness, with the best branch banks of other countries.

There is no doubt that the small branch institutions in Alabama, Georgia, Tennessee, Florida, in the West and in the Eastern states, are providing valuable facilities. There is positively no method, other than branch banking, of giving the people who live in small villages and in remote country districts the banking facilities to which they are entitled and which they possess in other countries. The postal banks cannot provide them, since they are merely to accept limited balances on deposit and they are not to discount or lend. Where there is a private bank or small local bank in a little place of the kind to which I have referred it too often charges high rates of interest, especially in the West, and it may act the part of a money-lending shark.

Honorable Mr. Murray, the present Comptroller of the Currency, has done much during his tenure of office to improve the position of the national banks. He has stiffened up the bank examiners and caused the bank directors to take a closer interest in the affairs of their respective institutions. According to newspaper dispatches he is said to be engaged now in an effort to eliminate weak banks from the national system. His plans are thus outlined by the Washington correspondent of the Boston "Transcript:" "A bank," says the comptroller, "should go into voluntary liquidation as soon as it is demonstrated to a reasonable certainty that it cannot be continued successfully, or as soon as the examiner ascertains that the officers and directors cannot or will not manage its affairs in accordance with safe banking practice."

So, when a bank is found to be in this position, the bank comptroller directs that it be immediately placed in a satisfactory condition by the officers and directors then in charge; or that, if these officers and directors are unable to do so, a new element of strength must be brought into the bank, or, in other words, it must be placed under new management. Failing either of these developments, the officers and directors are urged to liquidate.

Few will dispute that for the comptroller to aim at the elimination of weak and unsafe banks is eminently laudable and proper. These banks are a menace to the whole country, and every year they inflict loss upon the people. But it is to be remembered that in many small places these weak banks constitute all that the community has in the way of banking facilities. If they are wiped out there will be nothing—at least nothing respectable—in the banking

line to take their places. Also it should be clear that under the present system there must always be hundreds and perhaps thousands of banks operating with inexpert management. An institution starting in a small place cannot usually command the services of a skilled manager, and the directors in most cases know nothing of banking. Under a good system in which branch banking was really encouraged excellent facilities would be provided for thousands of small places which now have none whatever and at the same time the management and direction at these small places would be of a high character.

THE OPERATION OF THE MUTUAL SAVINGS BANK SYSTEM IN THE UNITED STATES, AND THE TREATMENT OF SAVINGS DEPOSITS

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Probably comparatively few of the readers of this paper realize the immense amount of money deposited in the savings banks of the United States. In addition to the institutions which are known as savings banks, a vast amount is undoubtedly held by national and state banks in states where mutual savings banks are unknown.

The popular impression is that in 1810, or exactly one hundred years ago, the first savings bank was started in Ruthwell, Scotland, by Rev. Henry Duncan. There is considerable doubt about the date that savings banks were actually started. The writer believes that the statement made elsewhere in this paper that they were first founded in Hamburg, Germany, in 1765, is correct. The "Encyclopedia Brittanica" states that savings banks were one of the "many excellent projects of Daniel Defoe in 1697;" but there seems to be no special authority for this statement.

From the best information available, it appears there are but thirteen states which authorize non-stock savings banks with restricted investments, as follows: Connecticut, Indiana, Maine, Massachusetts, Minnesota, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, West Virginia, and Wisconsin. With the exceptions of Indiana, Minnesota, and Wisconsin, these banks are all on the North Atlantic seaboard. Other states authorize stock banks for savings only with restricted investments, and these are California, Colorado, Florida, Idaho, Iowa, Michigan, Missouri, Montana, Nebraska, Nevada, Ohio, Texas, and Wyoming.

This paper, however, is to deal rather with the banks generally known as savings banks, and will have to do with the purely mutual savings banks, the first of which was founded in Germany, in 1765. From this small beginning, grew the great system which has done so much to help the small depositor and investor of the United States.

In the State of Massachusetts alone, October 30, 1909, there was on deposit in the mutual savings banks, of which there are one hundred and eighty-nine, the immense sum of $743,101,481. These represented 2,040,894 depositors with an average account of $364. The total cost of the management which had to do with the handling of this vast sum of money was $1,929,012, or about twenty-six one hundredths of one per cent. In the national banks and trust companies of Massachusetts on the same date, there was undoubtedly a tremendous sum of money which was made up of savings deposits, but which could not be so classified, as they were subject to check.

Using, then, the thrifty old Bay State as an example, it is the purpose of this paper, instead of giving a mass of statistics and figures, to give first an idea of the scope of the work done by the purely mutual savings banks. These, as many do not understand, are agencies authorized and sanctioned by the state to collect and receive savings deposits, which must be invested or loaned as the state laws prescribe, and the profits of which must be returned to the depositors in dividends.

Trustee savings banks were started originally by a philanthropist; and they must, of course, continue to be started, if started they are, and managed by philanthropists in the future. Still using our ideal Massachusetts savings banks as an illustration, say fifty men are the corporators of a bank. Of these, not more than three-fifths may be trustees, and the trustees must elect a number, ordinarily five, who shall be the board of investment, who exercise the same functions as the directors of a national bank should in its management. Then there is a president, treasurer, and a vice or assistant treasurer. Ordinarily but two of these officials are paid large salaries; and the use of the word "large" here is qualified, as the salaries paid in savings banks as a rule are much less than those in national banks or trust companies of the same size. The trustees must meet quarterly, and sometimes oftener, and serve absolutely without compensation. The board of investment ordinarily receive pay for each time they attend meetings; and the members of the board who actually do work in the inspection of loans, or otherwise, are paid a small fee for each service rendered.

Now, the money making spirit of the age causes the average banker to deplore the fact that all the profits accumulated must be returned to the depositors in dividends. He feels, while he does

not admit it, that if it were not for the savings bank, his national bank, trust company, or state bank, could get the deposits, pay a lower interest rate to the depositor than the savings banks pay, and pile up a handsome dividend for the stockholders. For this and other reasons, the writer of this paper doubts whether many more purely mutual savings banks are started or can be successfully operated in states that are not entirely familiar with their splendid usefulness.

The function and efficiency of Massachusetts savings banks cannot be misunderstood or questioned; whether or not the policy of the banks is sufficiently aggressive is seriously doubted. Among bank officials in the smaller communities, there has been a feeling of reluctance to advertise, and in the large cities, the banks, many of them, do not seem to care to grow. Many of the big banks, are somewhat overawing to the average depositor, and it takes too long to make a deposit or withdrawal. On the loaning and investment end of the business, it is, of course, easier in a very large bank to buy bonds which are perfectly safe but which pay a very low rate of interest and to make immense loans on city property, also at a very low rate of interest, than it is to loan to the small borrower. Unquestionably—this is not intended as a criticism of any in particular—the attitude of the large city banks has had a tendency to make the savings banks unpopular.

The limiting of the amounts received from each depositor by the mutual savings bank is a very potent factor in the strength of these truly remarkable institutions. In New York the limit is three thousand dollars from any one depositor; but it is believed that the Massachusetts law, which restricts the amount received to one thousand dollars and allows the money to remain in the bank until it doubles, is safer.

In the Massachusetts savings banks, the average amount to each depositor's credit in 1909, as previously stated, was three hundred and sixty-four dollars. Among the best conducted banks the constant aim of the officials is to reduce the average of deposits, that is, to increase the number of depositors without increasing the deposits proportionally. While this makes a great deal more work in a clerical way for the bank, it is, as is obvious, of great advantage to the bank should there be a run or at a time when the withdrawals exceed the deposits.

While the function of the savings banks, when properly organized, is really educational rather than economic, one phase of their affairs is worth speaking of. Here in Massachusetts, the depositor has no tax to pay on his money in the savings bank, but the banks themselves must pay a tax of one-half of one per cent on their deposits. In Massachusetts in 1908 the running expenses of the state were over twelve million dollars, and of this, the savings banks paid in taxes one million nine hundred thousand dollars, or practically fifteen and one-half per cent of the total expenses. Few people know that savings banks must pay the tax on their deposits, and the reader must realize what a tremendous help financially it is to the good old Bay State that it has so many savings banks in it.

The savings banks should furnish a safe place for the deposit of wages and small earnings, paying a fair interest to its depositors; but its chief object should be to teach the art of saving. In that sense it is educational, as stated in a previous paragraph, and there can be nothing compulsory in its methods as there is in co-operative banks. It must in every way make an effort to have its banking rooms, its clerical force, and its business, conducted with as little red tape, and made as attractive, as possible.

There is a great deal of popular misapprehension about unclaimed accounts, and many people think these unclaimed deposits are absorbed by the bank with an actual loss to the heirs or to those who originally made the deposits. This is a fallacy, for in most states, as in Massachusetts, every fifth year a return of these accounts must be made to the bank commissioner. In 1907 there were 1,921 accounts in the 189 Massachusetts savings banks, aggregating $567,932.85 on which no deposit or withdrawal had been made for twenty years, and these were duly advertised as required by law and the money will ultimately go to the state, who will return it to the rightful owners, should they appear.

It may be well to quote the Massachusetts statute covering this point, as there is so much misunderstanding about it. The law quoted is absolutely fair, and one which any state may well follow:

> The probate court shall, upon the application of the attorney general and after public notice, order and decree that all amounts of money heretofore or hereafter deposited with any savings bank or trust company to the credit of depositors who have not made a deposit on said account or withdrawn any part thereof or the interest, or on whose pass books the interest has not been

added, which shall have remained unclaimed for more than thirty years after the date of such last deposit, withdrawal of any part of principal or interest, or adding of interest on the pass book, and for which no claimant is known or the depositor of it cannot be found, shall, with the increase and proceeds thereof, be paid to the treasurer and receiver general, to be held and used by him according to law, subject to be repaid to the person having and establishing a lawful right thereto, with interest at the rate of three per cent per annum from the time when it was so paid to said treasurer to the time when it is paid over by him to such persons.

Much of the legislation aimed at savings banks, particularly in Massachusetts, is most unwise and represents some misguided enthusiast or some one who has a personal miff against some bank or some bank officer. However, there is occasionally a bill presented which has desirable features; but it seems almost as if the old conservative banker wanted to do things just as he has always done them. Hence, at a hearing before a legislative committee, a savings bank official frequently appears, sometimes properly authorized by an association or bank, but ordinarily entirely on his own responsibility, opposing blindly something which may have many desirable features.

The writer firmly believes that there are several innovations that savings banks could adopt which would not only tend to popularize them, but actually to make them more useful in their various communities. Every savings bank should be open at least one evening a week for the benefit of the very people it is trying to help, the working classes who cannot go to the bank during the usual hours without losing time. Many do this, but the majority do not.

The active officers and clerical force of a saving bank should be selected with great care, much more so than the same people holding positions in a commercial bank; this for the reason that the average savings bank depositor does not understand, at first, just what he is expected to do, and oftentimes in honesty does many provoking and annoying things. Tact and patience are required to explain the various steps; and these, I regret to say, are not always in evidence in the savings banks.

Right along this line, there is another and a very practical way savings bank officials could greatly increase the scope of the work their banks now do, and this is particularly true of manufacturing

cities. The officials should at any time, when invited, be free to talk before schools, woman's clubs, labor unions, young people's religious or other organizations, not to advertise the particular bank with which they are connected, but to explain in a large sense the work, usefulness, and earning power of the savings bank accounts. In any audience there are always some who can be enlightened, and there is practically no limit to the opportunities in this direction.

Savings banks should advertise, I firmly believe, and may receive as direct benefits in increased deposits as would a store in advertising a bargain sale.

Another feature which would probably vastly help the smaller communities where there are no banks of any kind, would be branch savings banks. While the postal savings banks will undoubtedly take care of a great deal of this business, yet, on account of the lower rate of interest they will pay, these branches should be successful. The Massachusetts law says that a bank may, with the written permission and under regulations approved by the bank commissioner, maintain and establish one or more branch offices, for the receipt of deposits only, in the city or town in which its bank is located, or in towns not more than fifteen miles distant therefrom, in which there is no savings bank at the time when such permission is given. While but one bank, I believe, has taken advantage of this, there is undoubtedly a great need for these branches, and the trustees of savings banks should consider them seriously.

Another way in which the mutual savings bank may be of inestimable benefit to the working man, is in the savings bank life insurance plan. In Massachusetts, savings banks have been permitted to enter into it for the past few years and two banks have tried the experiment. There is an entirely natural reluctance among the trustees of the ordinary savings bank to go into anything so radical as the savings bank insurance, which, as may not be generally known, is practically industrial insurance at cost. Should this be taken up by the banks of Massachusetts generally, and receive any support from the working classes, it would undoubtedly operate as a substitute for the old-age pensions of Germany and England and be much more desirable. Some of the most level-headed business men of Massachusetts are strongly in favor of all savings banks opening an insurance department, but as yet it is an experiment and cannot be said positively from experience to be of benefit to

the banks or to their depositors. The real question to decide is, granting that involuntary insurance is bad in principle, can voluntary insurance ever be popular enough to be successful?

Another way in which the savings bank could be much more useful is to work more in co-operation with the advocates of the school stamp savings. There are many of these in several of the Eastern states which do good work and are of unquestioned benefit to the children in teaching them to be thrifty, even if the money is not deposited in a bank. It would be better, however, if the stamps which the children buy were redeemable only at a bank rather than at the office of the associated charities, or some similar organization, as is ordinarily the case. There should be no opportunity for the child's confusing in his mind the saving of his pennies with any charitable or even religious organization. While these small accounts cause more or less bother to the teller at a bank, this should be more than offset by the ideas of thrift that would be inculcated in the mind of the child.

The school savings were first adopted in 1834 in a school in Le Mans, France. In 1846, the system was adopted in Würtemburg, and in Budapest, in 1866. The same year, in Belgium, one of the professors of the University of Ghent traveled about the kingdom explaining the advantages of the school system; and, by 1891, nearly $800,000 had been saved in the banks by the children of that country alone. France now leads the world in this educational and thrifty work, and the system has been introduced in most of the countries of Europe. The writer believes that this work should be talked by savings bank officials with the idea that the banks cheerfully do the clerical work, if the teachers, who ordinarily collect the money, would make special efforts to see that the child be directed to put in the bank at least part of his money.

The vital question is, do these savings banks invest their deposits safely? There can be no question about it whatever. The mutual savings banks of New York and the New England states, for instance, have as small proportion of losses as any banking institutions in the world. As previously stated in this paper, the managing board of trustees is a body of men who have no other motive in giving their services than their devotion to the cause, and they receive no pecuniary reward. This greatly reduces the chances of dishonesty or of a betrayal of the trust; and while there are, and

probably always will be, instances of dishonesty in savings banks, the record is wonderful considering the volume of business done.

The chief feature in the assets of a savings bank is its mortgage loan. This is ordinarily the largest item as well as the most important; for in its policy and care-taking of its loans on real estate lies the real success of the bank. While it is easier to make the large loans on the city block, which bear a low rate of interest, it is true that the bank which confines its energies to this line alone does not perform its real work in the community. A mutual savings bank should always be glad to loan on real estate to the small borrower and to the man who is helping a city to grow by building homes for its mill employees. Such loans as these are really more remunerative to the bank, as they yield a larger interest return; but they do, of course, make a great deal of work for the bank's force.

Among the best conducted banks of the writer's personal acquaintance, it is now the custom to vote loans with the understanding that the principal will be reduced not less than so much each year, fixing the amount by the opinion of the bank's inspectors as to what the property would depreciate in value each year. As a matter of fact, a reinspection of all mortgage loans is now required by the Massachusetts law, which demands that after a loan has been held by a bank for five years, not less than two members of the board of investment shall certify in writing according to their best judgment the value of the premises mortgaged, and the premises shall be revalued in the same manner every five years as long as they are mortgaged to the bank. Unfortunately, it has been the custom of some banks to make excessive loans, and of other banks to make a loan and never look at it again until their attention was called to it by a default in interest payment or taxes, when they find a run-down piece of property on their hands. Thus, as I have said, the real estate loans are really the most important feature in a bank's statement.

Then the bonds; and here, of course, we have assets that should be absolutely gilt-edged, as the ordinary savings bank buys only railroad or municipal bonds of whose validity and security there can be no question. As has been hinted in this paper, however, a bank may very easily have too many bonds which pay a small interest return but which are easier for its officers to handle; and, therefore, while very strong financially, such banks are really earn-

ing less than they should and therefore are not fair to the depositors. In the panic of 1907, some of the savings banks found out that bonds were not so fluid an asset as they had thought.

There is a great difference in the amount of personal loans held by savings banks; and there should be, as there is a great difference in the capacity of different boards of investment to pass on a personal loan. The writer is using the term "personal loan" in the sense of any loan that is made on names alone or on collateral security. Many banks have boards on which are national bank directors or officers who are entirely competent to pass on paper. Other banks, generally in the smaller communities, know nothing about such things at all, and should confine their energies to other lines. As a matter of fact, very few losses have ever been made by Massachusetts savings banks on strictly personal loans, that is, loans without collateral. These are ordinarily looked over with great care, while a collateral loan may be given less attention. These personal loans yield a higher rate of interest, generally, than even mortgage loans, are much more fluid; and, properly made, a certain amount of them are very desirable in a bank's assets. In Massachusetts a bank may lend not exceeding one-third of its assets in such securities.

October 24, 1907, Mr. Charles A. Conant published, in the New York "Evening Post," an article which has a direct bearing on the matter we are now discussing; and while it was written as an abstract proposition, certain phases of it seem to apply to the desirability of savings banks carrying some personal loans, otherwise and commonly known as commercial paper. He stated that

> The piling up of loans upon pyramids of inflated stocks and bonds is due in a large degree to the great development of industrial securities in recent years. Such securities do not represent circulating capital but fixed capital. They are simply obligations or shares in mill, railway, or mine, which represent a permanent investment. . . . Securities circulate, but the property they represent is fixed. They are not, therefore, in any proper economic sense circulating capital and are not the best basis for the investment of deposits payable on demand. Commercial paper represents circulating capital. In other words, it is the product of purchases on raw material which are converted in a short time into finished products whose sale for consumption affords the means to pay off the paper and thereby closes the transaction. When money is borrowed on securities, no transaction of this character takes place and there is no natural and normal date for closing the transaction. Managers of banks seek to give the character of circulating capital to securities by advancing

money on them subject to repayment at call. This system works admirably in periods of prosperity, but it causes convulsion in times of adversity. The owner of a part of a mill, railroad, or mine cannot convert the property into circulating capital. In his efforts to get rid of his share of it, when he finds that the banks are curtailing their loans, he is compelled to make great sacrifices or shoulder the loss upon the banks by failing to make good his margin. . . . Nothing of this kind occurs in dealing with commercial paper and the losses thereon are calculable and, as a matter of fact, are a fraction less than one per cent per annum.

I believe this to be sound reasoning and, from experience, one bank, of which I have personal knowledge, which has been in successful operation for sixty-four years, absolutely bears out the contention of Mr. Conant.

Going back to the statement made early in this discussion, the writer, for a variety of reasons, doubts whether many more purely mutual savings banks will be started, but this does not imply that the people will be any less saving. It would be ridiculous for a bank man in New York, for instance, to go to Illinois and try to get the legislature there to pass laws similar to that of New York or any of the New England states in regard to savings banks; this for the reason that the present Illinois law seems to work absolutely satisfactorily and with entire safety to the depositor where the banks are allowed to do practically all kinds of business. It works against the depositors in one way, of course, that they receive a lower interest return than they would in a bank in one of the Northern Atlantic seaboard states. But that is not so essential, so long as their deposits are safe.

Michigan has excellent laws, due, in a large degree, as the writer believes, to the efforts and activities of Mr. J. H. Johnson, president of the Peninsular Savings Bank of Detroit, Michigan.

Assuming for the sake of argument that the states that do not now have a mutual savings bank law will not pass one, would it not be vastly better if the institutions which do receive savings bank deposits were compelled to segregate them and invest their savings bank deposits along the lines that the mutual savings banks are now compelled to, or as a probate judge in the various states would allow trust funds to be invested? The writer has given this subject much thought and is firmly convinced that, ultimately, all savings deposits must be segregated.

In Massachusetts, a few years ago, a bank was looted by an

official who juggled the securities of a national bank and savings bank with which he was connected in such a way as to deceive the examiners. United States Senator W. Murray Crane, one of the shrewdest, most far-sighted and kindliest of men, then governor of the state, put a law through the legislature absolutely separating national and savings banks and not allowing one man to serve as an officer of both kinds of banks. In spite of the active opposition of the banks, this law was passed practically unanimously, and it has proven to be most wise legislaion. However, trust companies sprang up everywhere and these began to do exactly what national banks and savings banks were not allowed to do, that is, all kinds of business under one roof. So, very recently, the Massachusetts legislature passed a law compelling trust companies to segregate their savings deposits. The writer trusts their officials are having no difficulty in defining what of their deposits are actually savings.

Suppose there should be in the city of Chicago, for instance, a failure of one of the big national banks or trust companies and it should develop that a vast number of poor people who had entrusted their savings to the savings department had been hit, the legislature would pass a bill compelling segregation and division of the banks just as quickly as they did in Massachusetts, whose legislature is proverbially conservative and careful.

Segregation is, and probably will be for a long time, unpopular with the trust company or national bank man, the great majority of them looking upon it with distrust. I feel, however, had they viewed it rightly five years ago, that they would not have had the postal savings bank forced upon them. I firmly believe, as was expressed in a recommendation of the law committee of the savings bank section of the American Bankers' Association, of which the writer is a member, "Savings deposits in all banking institutions should be segregated from commercial and other deposits and invested in such classes of loans and securities as experience has shown to be amply safe, and that such investments should be held for the special benefit of the savings depositors."

In the states, then, which have no mutual savings bank law, I look forward to seeing tremendous savings deposits in the national banks, trust companies, and state banks. The mutual savings bank deposits will grow proportionately, as they always have, while in the West and South, with their magnificent futures, these other

banks should get the deposits. I firmly believe that the postal savings banks will get the bulk of their deposits in the West and South because there are no mutual savings banks and because the depositor realizes that his money is placed in a bank operated for private profit, where, if disaster comes, he must lose as would the ordinary commercial depositor.

While it will be slow in coming, I hope to see savings deposits, wherever held, segregated. Even if my work were not in a conservative New England savings bank, I would as strongly advocate as I do now the segregation of deposits. I can conceive of no better advertisement for a trust company, being operated, for instance, in a large city in New Jersey, than to advertise for savings deposits and to say that *there* such deposits are *segregated* and that the poor people's money is safe anyway regardless of what might happen to the bank.

As the postal savings banks will be in operation next year, a word or two of them may be of interest here. There is no question but that savings banks first came under legislative control in Great Britain, and peculiarly enough, it was also there that the postal savings bank was first started.

While this paper is supposed to deal with savings banks alone, so many of the officials of not only savings banks, but trust companies and national banks as well, opposed the passing of the postal savings bank bill that it is fair for the writer to state here that since he has made a study of the question and visited the West and South, he has become a staunch advocate of the postal savings bank. I believe that they will be a good thing for the government of the United States and a splendid thing for the people, especially the newcomer, who has more confidence in the government than in the banks. I believe that in any locality, even in the New England states, there is a certain class of people who will deposit money now concealed in old teapots and other equally desirable places, which has never, and would never, get into any existing banking institution. I believe it is the function of a bank official, and especially of a savings bank official, to aid in every way he can the wage earner, and especially the very poor, to be thrifty. Whether or not they happen to deposit in the bank or class of banks that he represents should not be considered; but the banker should look at it, as congress evidently did, in the largest sense. This matter, more-

over, is one in which politics should not be permitted to enter one particle.

The English postal savings bank went into operation first, in 1861, in England alone; but in 1862 it was extended to Scotland and Ireland. The following classification of patrons taken from a recent annual report is interesting and shows that the banks are doing good work:

Professional	1.55
Official	2.81
Educational	1.01
Commercial	3.88
Agricultural and fishing	1.33
Industrial	18.43
Railway, etc.	2.96
Tradesmen and other assistants	8.14
Domestics	8.61
Miscellaneous	0.37
Married women, widows and children	50.41

Postal savings banks have spread rapidly, particularly among progressive countries. Canada adopted them in 1868, Belgium in 1870, Italy in 1876, The Netherlands in 1881, France and Sweden in 1882, Austria in 1883, Hungary in 1886, and still later they were adopted by Finland, Russia and a number of the British colonies in Australia and Africa, and finally by Japan. In all these countries, the postal savings bank has proved of inestimable value to the government and the people. If in the United States, politics can be kept out of the management of the banks, there is no question whatever in the writer's mind that they will be, inside of ten years, a wonderful factor in the welfare of the United States. The trustee or mutual savings bank cannot be relied upon to reach into the small communities nor to cover a wide territory. As earlier hinted in this article, it is best adapted to that community where the inhabitants are naturally conservative and philanthropic. Hence the remarkable success of these institutions in the New England States.

The postal savings bank affords a depository in every hamlet large enough to have a postoffice. If when the places are large enough for national banks or trust companies, the officials find that the true savings deposits are all going to the postal savings banks,

they should increase their interest rates and segregate their deposits and advertise the fact.

Savings deposits will continue to abound and grow, and the public, and the bank directors, must insist that the savings of the poor, of the man, woman and child who work to earn what they deposit in the bank, be kept safely. If it is too much to ask for mutual savings banks, then let us, in an educational and not pugnacious way, work for the segregation principle.

To summarize: It is obvious that the people of the United States are naturally the thriftiest in the world. The children of the immigrant who comes here unable to read or write, get at least a common school education and go to work. They earn money and they save it; and they become, as a whole, as the history of every New England manufacturing city proves, better citizens than their fathers. Such is the civilizing influence of America.

THE USE OF CREDIT CURRENCY BY COUNTRY BANKS

By J. P. Huston,
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The country merchant was, in primitive days, the leading financial agent in his little community. He was the legitimate precursor of the country banker of to-day. His shop or "store" was the clearing house of the community for surplus farm products. He naturally became at times the custodian of a portion at least of the surplus means of the community. He opened book credits, which were usually redeemable in trade; that is to say in goods from his shelves. He sometimes issued in exchange for produce so-called "scrip" which was legitimate asset currency, issued for value, and redeemable—in goods of course—on demand. This scrip had the advantage over a book credit of negotiability in petty transactions between neighbors, and served as primitive currency.

The country bank came next, authorized by state law to issue bank notes against its own credit to a limited amount, and with the legitimate requirement that a specie reserve be kept on hand for the redemption of the notes issued. The bank note issues of those early days were very loosely supervised by the various states, and we have heard much of the abuses which occurred under a system of practically free note issue by the banks. We have heard too little, however, of the remarkable assistance rendered by these pioneer banks in the development of the country. Deposit banking as known by us was but in its infancy, and the bank note was the instrument which enabled the banker of the period to extend necessary credit to the merchant and planter, so that commerce might thrive and agriculture prosper. Of metal money there was no sufficient hoard, and but for the advent of the bank note, the rapid development of the middle West would have been impossible.

The scrip issued by the country merchant served its purpose only in an isolated community, having but little connection with the outside world. The state bank note issue had a wider circulation, but its field of usefulness was still local and provincial, as the notes were usually subject to an exasperating discount when presented at

any distance from the point of issue. The notes issued under the "Suffolk Bank" system were, it is true, redeemable at par in Boston. The genesis of the national bank note issue may yet be found in the Suffolk Bank system. It was a vast improvement over the previous experiments made by our banks of issue. It was being perfected and proven by the acid test of experience, and but for the complete demoralization wrought in our financial system by the exigencies of the Civil War, the perfect bank note might have been wrought out through gradual evolution. The principles of redemption at money centers, together with the maintenance of adequate specie reserves, might have been developed by the banks, while public sentiment might have been educated into a proper understanding of the currency question, and correct systems of state or governmental examination and regulation gradually established. Distracting elements, producing great confusion of thought concerning currency matters, were introduced by the government issues of fiat money, and the suppression of the state bank note issues, which was a war measure enacted to make way for the national bank note secured by government bonds.

It is idle to dream of building again upon a foundation that has been destroyed. If we have lost sight of the true function of the bank note since we have adopted fiat money and the bond secured bank note, we have also developed to a higher degree of efficiency than any other race or people the use of deposit banking, and of the bank check. We have also become accustomed to the use of paper money of uniform design and of uniform value, acceptable alike in the largest money centers and in the most remote hamlets. We have gradually become accustomed to a system of governmental regulation and supervision of our currency which in the mind of the average citizen is equivalent to government guarantee. No sane mind will seriously propose at this late day the issue of any currency not equally uniform in design and of equally universal acceptability. Our paper currency henceforth must be maintained at par at all hazards. It must never again be circulated at a discount as in 1867, nor should it ever again be quoted at a premium as in 1907.

The note issue function was the most profitable feature of banking in the period preceding the civil war. With the development of our present extended system of deposit banking, our banking liabilities have become expanded almost to the limit of safety, when

we consider the deposit liabilities in proportion to the total volume of actual money of redemption. Indeed, it is probable that the expansion of bank credits through deposit liabilities, stimulated as it is by active competition among the banks, and fostered by the optimistic feeling so common to the American public, has already increased bank liabilities to such an extent as will render it unwise ever again to permit the banks to enter upon an era of general bank note issues as a source of profit. We are now working under a practically rigid system of paper money issues, with the profits of note issue a negligible quantity. To permit further bank note issues in ordinary times would only incite unwise inflation of our currency and undue expansion of bank liabilities as related to coin reserves. In point of fact, our issues of paper money are already redundant. We have some $356,000,000 of greenbacks encysted in our circulation. We prefer to permit it to remain rather than submit to the severe surgical operation necessary to its removal.

Our issue of bank notes seems to be limited only by the volume of United States bonds available for deposit to secure circulation. Any further issues of bond-secured bank notes would only induce unwise inflation. We have already in circulation as much bank note currency as the country can assimilate in normal times, and any increase in its volume would only serve to displace an equal volume of gold coin. This is a situation to be avoided, not invited. It should be our policy to strengthen our gold reserves, not to weaken them. To invite further exports of gold would only tend to further dilute a currency system which already rests upon a coin reserve sufficiently slender. It should be our policy, as it is the policy of European countries, to protect our gold reserves rather than to make the United States an open market for gold, from which all countries may draw freely at will. Our entire credit system rests upon a coin reserve sufficiently small and it is the part of prudence to strengthen our gold holdings rather than weaken them.

While we have a sufficient volume of currency to meet our requirements in normal times, unusual demands for currency, whether caused by abnormal business demands or by private hoarding proceeding from a feeling of distrust, result in conditions under which our currency supplies prove deficient. Perhaps this period of acute demand for currency has been preceded by a period of inactive demand, which resulted in the accumulation in money

centers of a plethora of currency. So much the worse for us, for this period of plenty has probably caused a loss of gold by export, for as we have no automatic way of retiring superfluous bank notes or greenbacks, we have usually contrived to ship gold as a superfluous commodity. Then when an abnormal demand for currency sets in, and we desire to recover some of the gold which has been exported, we sometimes find foreign supplies of gold more closely guarded than our own, so that we cannot bring the tide of importation of gold in our direction without making costly concessions which result in lower prices of commodities and securities, and a disturbed condition of business.

It is not a larger volume of currency which we need, but rather do we need a system which admits of some expansion and contraction other than is offered by the crude method of actual export and import of gold. The constant shifting of large sums of gold from one side of the Atlantic to the other is not only expensive, but is disturbing to the business of Europe as well as to the business of the United States. If our currency system had any measure of elasticity, we would provide for the minor changes in the demand of currency without having recourse to actual gold exports or imports. When an excess of currency accumulates in the reserve cities, a portion of our bank notes should be retired. When a demand for more notes to satisfy the demands of the crop-moving period appeared, we should be able to issue bank notes for temporary use. Thus, automatically, our hold on our stock of gold would be strengthened, and we would maintain our own reserves within control, and less often call upon the foreign money markets for aid in financing our own business requirements. Foreign money centers have complained that we too readily apply to their markets for financial assistance, and insist that we should arrange to settle our financial difficulties at home.

There is nothing automatic in the workings of our present currency laws. There must be something automatic in their operation if we wish to avoid a repetition of the currency famine of 1907. Some authority must be lodged somewhere for the issuance of an additional volume of currency when the demand for currency becomes so acute as to threaten the suspension of cash payments. This addition to the volume of money should be based upon liquid commercial assets, and should have an adequate coin reserve behind it. The banks of the country are the custodians of the best of all

liquid assets, as their credits are based upon advances covering transactions which are certain of liquidation within short periods. The sales of grain, meats, provisions, and manufactured articles in daily use liquidate credits rapidly, if time is only given for distribution from the producer to the consumer.

The banks also can acquire the coin necessary to maintain reserves against note issues, if the burden of maintaining coin reserves against bank note issues is placed upon the banks, and actual redemption of bank notes is provided for, instead of the present system of forced circulation of notes. We may not find a way at once for the retirement of the present volume of bond-secured bank notes, and they may remain with us indefinitely, always hampering our control of our own gold supplies, and rendering it all the more necessary that our reserves of gold be fully maintained. We can at least put a stop to further mischief of the same character, by avoiding the issue of any additional bonds bearing circulation privileges. Any further issues of government bonds should be issued with a view to finding a market with private investors among the people. They should not be issued with the avowed purpose of serving as a medium for the further permanent inflation of our currency, by placing them with the national banks as a basis for the permanent issue of an equal volume of practically unredeemable paper money.

The banks have both the credit and the resources necessary to provide all the currency needed for protection against such an emergency as the panic of 1907, or a much greater crisis even, if the banks are only permitted to use the undoubted resources and the credit with which we know them to be endowed.

Should the banks of the country be permitted to issue an additional volume of currency at crucial periods, and if so in what manner?

Congress by legislative action directly following the panic of 1907, has recognized that our financial difficulties of 1907 were aggravated by the non-elastic feature of our currency system. The Aldrich-Vreeland bill was enacted providing for the issue under sundry restrictions of so-called "emergency circulation" either by individual banks or by groups of banks to be organized as "National Currency Associations." The issue by individual banks still bore the time-honored requirement for the deposit of bonds to secure the

circulation thus issued. The provision for the organization of "National Currency Associations" contemplated a forced association of banks for the purpose, and did not make provision for the voluntary retirement of any bank from the association, after it had once attained membership.

Congress has also appointed a currency commission, which has investigated in an exhaustive manner the principal monetary systems of the world. It has prepared for publication various books and pamphlets bringing a study of the leading financial systems within the reach of all students of finance, but it has not yet vouchsafed any report of its deliberations. In the meantime discussions of the proposed issue of additional circulation by the banks have been general among the banking fraternity, and three several agencies have been suggested for its issuance:

First.—By the individual banks, as at present.

Second.—By clearing house associations, as through a modification of the "National Currency Association" authorized by the Aldrich-Vreeland bill.

Third.—By the organization of a Central Bank of Issue.

The question of the need for additional currency is primarily a question of cash reserves. It cannot be too often or too plainly stated that balances due from one bank to another bank are not cash reserves. Many country bankers who would have flatly denied this simple proposition in 1906 are now open to argument on the subject. The plain fact is, the country bankers do not carry cash reserves of any consequence at all. They only carry what an English banker would call "till money," and their real reserve is deposited with their city correspondent. Too often this city correspondent has redeposited the greater portion of the balance with a correspondent in a larger city, and this correspondent in turn has passed the bulk of the balance on to a yet greater financial center, until the actual cash reserve held against these duplicated deposits becomes attenuated indeed.

If the country bankers do not trouble themselves to carry an actual cash reserve of sufficient consequence to be of any avail in an emergency, but rather choose to rely upon their reserve agents in time of need, it seems that, in justice, the additional note issuing power should be given where it is most needed, to the banks which have by custom assumed the obligation to carry the country's reserves. Nor is the country banker, on the whole, inclined to be

jealous of his prerogative in the matter. The profit attendant upon note issue has already become so small that with a small volume of bank notes outstanding the country banker does not realize a profit sufficient to reconcile him to the accumulation of red-tape and detail work connected with the issue. It is recognized also that the additional circulation authorized will be so heavily taxed that it will be speedily redeemed and its issue will be more a matter of patriotism than of profit.

The banks of the reserve centers are the first to note any unusual pressure for currency. The country banker orders currency as occasion arises, from his nearest reserve correspondent, and when he has an excess of currency beyond his immediate needs, he ships the excess currency by express or registered mail to his city correspondent. Thus, in normal times, the country banker knows nothing of either a condition of scarcity of currency or of an excess of currency. He may have a surplus of loanable capital, or he may have a demand for loanable funds beyond his ability to meet these calls. When the country banker informs you that money is scarce in his section, he only means that loanable capital is scarce. If, at this juncture, a deposit of $10,000 in currency was made at his counter, he would in all likelihood at once express the entire amount to his city correspondent. Under ordinary conditions of so-called "tight money" what he desires is the use of a bank credit against which he may draw, not actual currency or coin.

The country banker never realizes that there is any scarcity of actual money until he calls upon his reserve correspondent for a shipment of currency, and does not get it. On the other hand, the banks of the reserve centers feel at once any unusual demand for currency or coin. When their cash reserves begin to fall, they are compelled to begin to contract their loans. We are compelled at times to throw overboard valuable cargo, in order to lighten the ship so that she may ride the waves. Sometimes the cargo thrown overboard is stocks, bonds and other securities, sometimes it is grain, live stock or cotton. Is not such valuable cargo worth saving, and had we not better build a better ship, more capable of carrying the load, rather than again suffer such unprecedented losses as were occasioned by the drastic and enforced liquidation which took place in 1903, and again in 1907?

The privilege of issuing uncovered notes is evidently one which

Congress is very unwilling to grant to individual banks, and the sentiment of the people in general is in accord with Congress in this particular instance. Indeed, the privilege of issuing uncovered notes is now recognized as having such a powerful influence on the control of reserves, and even of the money market itself, that countries, like England, France and Germany, restrict the power of issue to semi-governmental banks. In our own country there is a strong disposition on the part of the minority party to insist that the government itself should issue paper money to cover special requirements of crop-moving periods, or of periods of financial stress. There is also a spirit of unwillingness to grant this power of issue to individual banks, because of the fear that some failures might occasion losses which would impair confidence in the remaining issue, notwithstanding the safety fund requirement which all advocates of this form of issue have agreed upon as necessary to provide for the redemption of the notes. There is also a feeling of unwillingness to permit the banks any additional note-issuing functions, because the people are unwilling to grant to the banks by legislation any new sources of profit. The argument that the people would share the benefits which might occur if the lending powers of the banks were enlarged, is lost upon the opponents of the so-called asset-currency idea. If it is contended that an increase in the ability of the banks to extend accommodation will through competition result in lower and less variable interest rates, it is hinted in reply that the banks would be the chief, and in fact the only, beneficiaries. We have a large number of citizens who insist that the right to issue a token of any nature intended to pass as "money" is an exclusively governmental function. This minority has always opposed on principle the note-issue privilege of the national bank act, as so-called "favoritism" of the banks. They would most strenuously oppose any extension of the privilege in new directions, as a matter of general policy. They may only become reconciled to a proposed change of this character, if strictly limited in volume, issued under most rigid governmental supervision, and with the expectation that its provisions would be of occasional application only, with the hint of an emergency requirement as a justification for its being.

Very general opposition has recently developed to the further issue of government bonds to be used as a basis for bank note circulation. One of the most important currency reforms confronting

us is the necessity for breaking away from our old traditions of the bond-secured bank note. We have followed the practice of issuing bank notes to the practical limit of the government debt until we have reached the danger point. The government must have the power to borrow, but its requirements bear no relation to the needed volume of money. The government should find a market for its bonds among the people, and the sooner this is accomplished the sooner we will have taken one proper step on the way to a proper rehabilitation of our finances.

If we contemplate a departure from the bond-secured note issue, we must make some provision to take its place. Bond security is not necessary as a basis for an absolutely safe issue of bank notes. Such issue, however, must be under strict limitations of volume, with assured facilities for redemption. A proper forethought for the future development of our banking and currency administration along sound lines would also suggest a requirement for the maintenance of adequate reserves of coin against future bank note issues.

If the banks are to be permitted to issue notes secured by their general assets only, or upon the pledge of other securities that the government bonds issues to which we have become accustomed, there seems to be a popular demand that the banks shall collectively assume the responsibility for the redemption of the notes issued. The bank guarantee plan incorporated by one of the great political parties in its last national platform, and adopted by several of the states in the Middle West, is but an echo of this feeling..

There is also a fear in the minds of many that any provision permitting the issue by the individual banks of uncovered notes, or notes secured by the general credit of the banks only, and not by the pledge of any specific collateral, would result in very general over-issue, and consequent inflation. The temptation to issue notes to the maximum amount permitted by law would be very strong to all banks in new communities where capital is yet limited, and interest rates high. Banks located where such conditions prevail would no doubt issue notes to the full limit permissible, under the act, and send such notes away from home for circulation, as there would be no real demand for the notes at home. As these notes were presented for redemption, new notes would at once be taken out in their stead. As country banks and even state banks and trust companies located

in the larger cities do not make any distinction between legal tenders and bank notes in counting their cash reserves, the bank vaults of the state banks and trust companies would soon contain only bank notes as their actual reserve. This condition would be perilous in the extreme.

But, it may be asked, would not an issue of uncovered bank notes by a group of banks be open to the same objections as an issue by the individual banks?

In answer, it may be said that a limited issue of notes only is proposed, and it is easier to exercise admonitory control of a few institutions than over a large number. If the proposed currency should be issued by clearing house groups only, we have the combined wisdom and caution of the entire clearing house as a check against over issue. The rates of interest prevailing in any clearing house center are never so high that a tax of five per cent or even four per cent would not prove a deterrent against over issue, and provide for speedy redemption, while a tax of five per cent or even six per cent would not avail against a continuous issue by banks in some newly developed sections. If the banks of any clearing house located in any reserve center may be permitted to form their own group of banks, and adopt their own regulations for the conduct of the association after it has been formed, there is no reason why all the banks of the group should not become jointly and severally liable for the notes issued. Such association, of course, would be under the control and approval of the Treasury Department but should be a voluntary association, not such an involuntary association as was provided for by the provisions of the Aldrich-Vreeland bill.

The point of attack should be made the point of defense. The calls for currency concentrate upon the banks of the reserve cities, and the weapon of defense should be placed in their hands. When currency becomes redundant, the excess accumulates in the vaults of the banks of the reserve centers. As nearly all the large banks of the reserve centers are national banks, and are compelled to keep their reserves in coin or legal tenders, the bank notes will not be held in their vaults, as in the vaults of the country banks, as so-called "reserve," but must be paid out or held as a non-productive asset. There should be provision for redemption at any sub-treasury, and the reserve banks would under such provision promptly present for redemption all bank notes which came into their possession, when

the calls for currency from the interior had been succeeded by a return flow of currency beyond immediate needs.

There are many arguments against the mutual guarantee of deposits by the banks. There are no essential objections however to the mutual guarantee of bank notes by the associated banks of any large clearing house center, provided the banks are permitted to form a voluntary organization, admitting only banks of their own selection, and framing their own rules for the government of the association. There are cogent reasons for the safeguarding of the bank note which do not apply to the protection of the ordinary depositor. The holder of the bank note should not be asked to scrutinize the credit of the issuing bank. The security should be so absolute that no such scrutiny should be required. The bank depositor occupies a different relation to the banking world. The deposit of money in a bank is a voluntary matter. The depositor does not make deposits with a number of banks at random. He selects some single bank with which he opens an account. He should examine the character of the management, and advise himself of its manner of doing business. Intelligent criticism of this character is one of the very best safeguards of sound banking. The acceptance of a bank note is a different matter. The holder of the bank note has no opportunity to select the notes of any particular bank. He must accept or refuse the notes as offered him. He is an involuntary creditor. By usage he is called upon to accept in trade any bank notes offered without regard to the credit of the issuing bank. His responsibility is limited to the ability to distinguish a genuine bill from a counterfeit issue. The government has come to his aid in this particular by undertaking the printing of all bills issued, and by a highly organized secret service force has practically eliminated counterfeit issues.

The guarantee of bank notes differs from the proposed guarantee of bank deposits in another vital particular. The total liabilities assumed by the banks in jointly guaranteeing the bank notes issued by their respective clearing house associations would be limited in amount, and the liability would extend only to banks of their own locality, with whom they had entered a voluntary association, and with whose management they were duly conversant. The mutual guarantee of deposits would represent the involuntary assumption of liabilities, the possible volume of which staggers the

imagination. In the guarantee of bank notes, the issue is proposed to be made in limited volume and by selected banks. The guarantee of deposits represents the assumption of an illimitable liability, with no privilege on the part of the banks of making any selection of risks.

We cannot provide a proper bank note system and get entirely away from the human equation. We cannot construct a system absolutely automatic. Some final power, vested with final responsibility, subject to human judgment, must be available somewhere, or the system will break down at times. This final power we have found in the past in the United States Treasury. It was not designed to control the banking system. It was organized with an opposite purpose in view, of getting the government out of the banking business, and the fathers of the independent sub-treasury system little conceived that an emergency might ever arise under which the Treasury Department might be called upon to assume even a moral responsibility for the protection of the banking situation.

In practice, however, the Treasury Department has never been able to maintain an attitude of non-interference. The treasury, at times, acquires such excess of revenues that the withdrawal from circulation of the treasury holdings would prove a serious menace to business. On the other hand, in times of unreasonable and unreasoning financial disturbance, the pressure of public opinion has always prompted the Secretary of the Treasury to use the utmost resources of the government to assist in restoring financial order. The United States is the largest holder of cash in the world. It has larger cash revenues than any corporation in the United States. These possessions entail grave responsibilities, which cannot be ignored.

Thus, in practice, the Treasury Department and the banks have been compelled to co-operate in times of panic, and work hand in hand for the restoration of confidence. They co-operate clumsily for there is no statute law to assist them. The Treasury Department is not recognized by law to have any banking functions, yet at times it holds vast sums of government revenue, unused funds awaiting disbursement, in no wise differing from the deposit liabilities of the commercial banks, save that they are withdrawn from the channels of trade, and the commercial interests of the country are hampered by the withdrawal of hoarded money to the extent of the treasury holdings. The one appealing argument urged in favor of the Postal Savings Bank bill has been that the postal savings bank would bring

out of hiding considerable sums of money which is now being hoarded by timid people. The government has been the chief sinner in the matter of forcible and violent withdrawals of sums of actual cash from the channels of trade, and it may well set a good example to the nation by a change in its manner of handling its own revenues.

The Treasury Department is also charged with the responsibility of maintaining the redemption in coin of a vast volume of paper money. In fact the protection and maintenance of our gold holdings, a matter intimately connected with the questions of bank reserves and of the settlement of our foreign trade balances, is with us a distinctly treasury action. In all European countries these problems are assumed by the semi-governmental banks.

If the burden of the maintenance of cash payments is to be placed upon the banks, then the banks of the reserve cities, at least, being the banks which really carry the cash reserves of the country, should be given the liberty of using their undoubted credit and resources as a basis for the issue of a sufficient volume of notes, secured by clearing house certificates, to protect the nation from a currency famine. This was attempted in the Aldrich-Vreeland bill, but if this measure is to be permanently adopted, it should be revised in such manner that the banks may be permitted greater freedom of action.

If Congress or the people are unwilling to grant to the banks such note issuing power as may enable them to control the currency situation in time of panic, because of insistence that the power to coin money and to regulate the value thereof make it incumbent upon the government to furnish a supply of money adequate to the needs of the nation, then, our last resource is a semi-governmental bank of issue. The central bank idea has many advocates and many opponents. If the central bank is called into being, it will be compelled to exercise control not only over the available supply of cash reserves of the banks, but will be compelled to act as the final arbiter in the extension of credits, both in a banking sense and a commercial sense. When credits become greatly extended, the position of the central bank would not only be one of great responsibility, but also one of great power, both financial and moral. The chief objection which has been urged by the opponents of the central bank is that so great power over the money market should not be vested in any institution. The fear is expressed that the management

might at some time fall under the control of a single group of individuals, either of financial or political brotherhood, who might administer its affairs for their own personal aggrandizement.

The history of the first two banks of the United States has been pointed out as proof that any central bank organization in our country is a predestined failure. The comparison is unfortunate, but there is in fact no analogy between the United States banks of the earlier period and the proposed central bank of to-day. The first banks of the United States were direct and active competitors of the commercial banks of the period. The proposed central bank of this day would not be a competitor with the existing banks for commercial business. It would be a bank of banks, its ownership and control in the hands of the existing banks, but under quasi-governmental control. It would be the custodian of the final reserves of the banks, and would have in its control the reserve note issue power of the banks. It would have large responsibilities. The same responsibilities already exist, but rest upon the large aggregate number of existing banks. Each individual bank is apt, however, to treat his responsibility lightly, feeling perhaps that his small efforts to check a rising flood of speculation would have but little effect on the whole situation. Free banking advances personal aims only. We need some consolidation of existing banking responsibilities, in such manner as to recognize the claims of public duty.

The power to issue uncovered notes should be the last and final link in the line of reserves built up by the banks. The country banks make no attempt to carry the actual cash reserves necessary to be held against the enormous and growing mass of our bank book credits. Our reserves are concentrated at the money centers. Perhaps it is as well it should be so. There should be a gradual refining of credits from the small community on the outskirts of our commercial territory, through larger and larger centers of banking activity, until we come to the city whose wealth and banking power constitute it the financial center of the country. Here we expect to find credits more fluid and mobile, with a power of assimilation of all that is best of the financial offerings which, wherever they may originate, tend to draw upon this common center whenever the enterprise calls for the employment of other than local means.

The concentration of reserves has taken place as a natural evolution of banking. As the reserves have by common consent become

lodged in the larger money centers, the note issue power, which should be the last line in our defences, should be lodged in the banks of the large money centers. Being thus disposed, our reserves acquire greater mobility, for they may be promptly marshalled thence for the defence of any point which may for the time demand the use of unusual resources. Upon these money centers concentrates the demand for coin for export in payment of our foreign balances, for legal tenders to pay custom duties, for cash to move the cotton crop of the South, the wheat of the Middle West and the Northwest, and for any unusual call which may be occasioned at any time by any one of our manifold activities.

The maintenance of our banking reserves thus rests upon the banks of our larger money centers. The maintenance of reserves in banking is a vital matter. It has long been so understood by Congress, which requires the banks of the central reserve cities to maintain minimum reserves of actual cash in their vaults of twenty-five per cent of their deposits. No arbitrary rule will suffice however, to represent an adequate reserve. The demands upon it vary with the seasons, are strangely affected by foreign market conditions, by crop conditions, by frosts, floods, and earthquakes; by matters political, by labor conditions, and most of all by that mercurial and unmeasurable thing, public confidence or trust. The conservative banker must decide for himself, almost from day to day, revising constantly his views on the financial outlook, what minimum reserve is required. Even then his position is jeopardized, if the action of his neighbor is not governed by a policy equally sane and conservative. Competition is so strong among our banks, and the demand for a showing of earnings is so pressing upon our bank managers, that it would prove a real relief to many of them to relinquish in part the great responsibilities which the care of this reserve entails. With a central bank organized for the purpose, relieved by its charter from the strain for profits, and charged with an acknowledged responsibility for the management of our reserves, the maintenance of cash payments, and the redemption in gold of our paper money, our banking system would present a solidarity of organization, and an efficiency of action, which in the minds of many students of finance has been hitherto lacking.

STATE AND NATIONAL EXAMINATIONS OF BANKS

By Herbert G. Stockwell,
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Much unjust criticism has been made by bankers and bank examiners against each other, and the general public has frequently condemned both. When a trusted bank officer or clerk decamps with the bank's money the popular cry is heard to the effect that all bank men should be watched closer; and there is also heard the oft repeated demand, "Where was the bank examiner?" In the mutual effort to serve the public well and faithfully, cordial co-operation and perfect understanding between the banker and examiner should take the place of suspicion and distrust. Criticism is unjust when entertained before due consideration of all of the facts has been given.

As an examiner, I ought to believe that every bank officer and clerk is absolutely honest and conscientious, and my investigations should be directed to the proving of my theory; and as a bank officer, director or clerk, I ought to feel that the examinations have been instituted and conducted for my benefit as well as for those who have placed their trust in me. It frequently happens that unnecessary friction is allowed to creep in and destroy the best results that might otherwise be derived from the visits of the examiner. Constant contact with the many phases of the banking business in many banks enables the thoughtful examiner to see some of the relations between facts and uncertainties in a clearer light than is possible for some strictly local bank officers; and the friendly discussion with the examiner of such matters as arise in the course of his business would be of greater benefit to the banker than he could realize until he has experienced it. On the other hand, the trained banker can, if he will, impart to the examiner a knowledge of specific acts and circumstances surrounding specific transactions, to be learned in no other way.

The best examination results from the joint efforts of the banker and examiner working together, each possessing good judgment and tact, and each having an earnest desire that the bank

be searched through for an untoward act or transaction that ought to be uprooted before it has fastened its ugly tentacles. A bank official expressed the idea of value to be obtained from contact with the examiner in the following language:

> We bank officers are so close to the scene of action, that we do not look upon it in the same way as an outsider and the opinion of another is often refreshing and helpful.

In the consideration of the subject of an examination of state and national banks, we should keep in mind the immense task imposed upon those responsible for such labors. The Monetary Commission reports that in April, 1909, there were 22,491 banks of all classes doing business in the United States. These banks handle assets amounting to the vast aggregate of $19,583,410,393, which in total and in detail must be accounted for, and, with few exceptions, examined one or more times each year by the state or national examiners. The number of examinations required by the laws of the states varies from one examination to five annually. The national bank examiners visit the bank as nearly twice each year as possible.

The examiner has to contend with a great many difficulties not ordinarily known to the public. One of the obstacles consists in the attitude of the directors and officers when violations of the law are called to their attention. This, of course, is more particularly true in some country banks, where the directors have had very little general experience outside of the small trades or occupations in which they are engaged, many of them being farmers.

Requirements of the States

With but few exceptions all of the states have provisions for examinations of banks, although some of the laws regulating the control of banking have been but recently enacted. In Arkansas, the state auditor says, there are no banking laws and no examinations of banks, and so late as 1909 the Superintendent of Banking in Ohio states that none of the banks of the state had ever been examined before.

From Arkansas, where no examinations of any kind are required, it is a long cry to Rhode Island, where provision is made not only for two examinations annually by the bank commission,

but in addition private examinations are required by law. So far as I have been able to learn, no state in our union has gone the lengths of Rhode Island in directing how examinations, other than official, shall be made. A letter dated June 10, 1910, addressed to the banks, signed by the bank commissioner, calls attention in the following language to the law recently passed: "Heretofore the law laid this duty directly upon a committee of the trustees, but now this duty must be performed by a certified public accountant of this state, whose examinations and reports must cover subjects and be in a form satisfactory to the bank commissioner." At the end of the letter are given the names and addresses of the certified public accountants of Rhode Island.

Between these two extremes the other state banking departments are operating under laws of varying force and scope.

National Banking Supervision

The Comptroller of the Currency is the superintendent of the national banks. In his last report dated December 6, 1909, he states that on September 1, 1909, there were 6,977 national banks in operation grouped as to capital into the following divisions:

Capital			Number
	$25,000		1,815
Over	25,000	less than $50,000	384
Over	50,000	less than 100,000	2,217
Over	100,000	less than 250,000	1,909
Over	250,000	less than 1,000,000	492
Over	1,000,000	less than 5,000,000	149
	5,000,000	and over	11
	Total		6,977

The national act from which the Comptroller of the Currency derives his power was originally passed as a currency measure. The government desired to place the issue of bank currency in banks operating under a national charter and at the same time provide a means for marketing its bonds. The original scope of the examiner's duties seems to have limited the examinations somewhat to such inspection as would assure the comptroller that the notes issued by the bank would be paid upon presentation at the bank, and thus prevent the necessity of sale of the bonds deposited in Washington as collateral security for the notes. A few hours'

work in each bank seemed to be all that was considered necessary for such purposes as were originally in contemplation; and the fee was, in 1862, deemed ample compensation. In some cases more than one bank examination could be completed in a day's work; thus a comfortable income resulted to the examiner. The act of Congress governing the scope of the duties of the examiners has not been changed in this respect from that day to this, but the rulings of the several comptrollers have gradually increased the labor of the examiners to such an extent that with few exceptions they are to-day very poorly paid for the amount of work they are required to do.

Part of the enlargement in the scope of the examination is attributable to the accumulation of experience which each successive comptroller has found at hand, partly to recommendations of bank officers; but the bulk of the work now done by the national bank examiner may fairly be attributed to the zeal on the part of all officials inspired by the pressure of public opinion. Each embezzlement of bank funds by officers or clerks and each failure of national banks has created in the minds of the general public a feeling that greater efficiency in the comptroller's office would have prevented the loss. Thus, the comptrollers stimulated to increased endeavor, have added from time to time things necessary for the examiner to do to safeguard the funds of the depositors, until, at present, instead of a cursory inspection of the available assets of a bank for the purpose of determining that the national bank currency would be honored, the examiner must go into, and report upon, a multitude of details, originally scarcely contemplated as necessary or desirable.

The most recently reported order of the comptroller will illustrate as well as any other the difference in the present and former requirements. The examiners will now be required to exercise judgment as to whether a weak bank should be allowed to continue in business; and for the purpose of coming to some conclusion in the matter without waiting to file their reports, they should call the directors to a meeting to consider the financial condition of the bank with a view of liquidation. Think of it! A man who may possibly receive the mere pittance of $20.00 for an examination of a bank must be of such caliber that dependence may be placed upon his judgment as to whether that bank should be closed up or

nursed along. This disproportion between brains required and the compensation allowed should be adjusted without delay.

While there is some adverse criticism of the present Comptroller of the Currency in his exacting demands upon the directors and officers of the national banks for a better performance of their duties, it seems to be pretty generally conceded that such steps are well considered; that the comptroller should enforce the law as he finds it, and that this will result in great improvements in the national banking business. If the law is unjust in any way, the quickest means by which it can be changed is for him to enforce it. That many of the points on which he insists are considered good is shown in the reports of many state bank commissioners. His example is being followed by numerous state officials, while others express the regret that they have not the power to adopt some of the requirements of his office.

One of the greatest difficulties confronting all banking departments is the tendency on the part of banks to loan money to their customers in excess of the amount declared by law to be the limit to which loans can be made. The comptroller states that, in spite of his watchfulness, caution, and remonstrances, over fifteen per cent of the total number of banks doing business report excessive loans.

The amount that can be loaned to any individual, firm, or corporation is an amount equal to ten per cent of the bank's capital and surplus, providing that the total of such loan does not exceed an amount equal to thirty per cent of the capital stock of the bank. The penalty for violation of this law is so severe that it has rarely been imposed, and many banks openly violate the law on the ground that it is unjust and that it interferes with their business. A bank with a capital and surplus of $1,000,000 could accommodate a wealthy and desirable customer with only $100,000 if the law were strictly obeyed, yet the bank might have many millions of deposits available for loans. For the bank to make a larger loan, there must be an increase in capital or a change in the law. That the banks do not consider the law one to be obeyed to the letter is shown in the fact that over one thousand banks voluntarily reported excessive loans in September, 1909.

A new feature adopted by the present comptroller consists in the organization of the examiners in the field. There are now

between 95 and 100 national bank examiners who have been grouped or classified into eleven or twelve territorial districts by the comptroller. It is intended that these groups of examiners shall meet twice a year for the exchange of information regarding borrowers in their district, and a discussion of any suggested improvements in the examinations that may be made under existing conditions.

Each group is presided over by a chairman, who assigns to each examiner the task of writing a paper to be read at the meeting. The chairman himself also writes a paper, and the meetings are intended to be of great use to the examiners in tending to perfect them in their work. This organization of examiners into these associations, if properly handled and maintained, will bring about much, although in the hands of immature men there is grave danger of indiscreet treatment of the confidential knowledge entrusted to them. This must be carefully guarded against.

Qualifications Required of Examiners by State and National Authorities

Unfortunately, at least in the past, political influence more than ability has assisted candidates to obtain the position of examiner. Perhaps the following is an extreme illustration: A newly appointed examiner was sent to an old and experienced examiner for training. In a conversation with the appointee, it was learned that he knew nothing about the business, possessed no experience whatever in banking and had, in fact, neither applied for, nor desired, the position of examiner. He was, however, a supporter of certain political influences in his state and was filled with a laudable desire to become a United States marshal or assistant United States district attorney. His benefactors did not happen to have just such a job handy so they asked the comptroller to appoint him bank examiner. He frankly told the comptroller, he said, that he knew nothing about a bank. The comptroller, it is said, told him that he could learn and he was thereupon sent to the old examiner for instructions. Extremes meet among the examiners, as well as in other classes. Some examiners have served years of useful employment in a bank, after which they have been taken to Washington, where they were thoroughly drilled in the analysis of reports of examina-

tions. After all this training, they were allowed to go out in the field.

It is very fortunate indeed that the comptrollers have to a large extent disregarded political pressure and that very few examiners have been removed because of their politics; the examiners appointed purely for political reasons are being carefully weeded out, and to-day it may be said that the examiners are as a class equal, if not superior, to any other body in the national or state service.

In some states the examiners are required to have had certain qualifications, including a definite number of years of active bank experience, while in other states the matter is left to the discretion of the bank commissioners. In Texas, for example, every examiner must have been an "expert bookkeeper and bank accountant" and must have had practical experience in the banking business for at least five years. This expert receives a salary of $2,000 per annum and must furnish a bond of $10,000. In West Virginia the candidate must be "skilled in the science of bookkeeping and banking" and must have had at least "two years'" experience as cashier or assistant cashier in a bank, or shall have served at least two years as assistant commissioner of banking, banking examiner, or as an accounting officer of the state."

A curious condition was discovered in Georgia by the state treasurer, who in that state is also bank examiner. In his report for the year 1909 he says:

> In this department I found that bank examiners were in business for their health and each had resigned positions to accept service in the department because it afforded them outdoor work, although at a less salary. Up to the present time the salaries range from $1,200 to $2,000 per annum, the same being paid out of fees received from the banks examined, and, be it said to the credit of the banks throughout the state, that they are willing to pay a larger fee for a more thorough examination such as will keep in the service accountants of ability at salaries commensurate with the service rendered.

In discussing the qualifications of the bank examiner the commissioner of Kansas in his report for the year 1908 says:

> In short, judgment is the best asset of a bank examiner and the person who has found judgment supplemented with experience as an examiner is the one whose services become invaluable to the state, and such a bank examiner should be retained regardless of political affiliation.

In an address by Hon. H. M. Zimmerman before the Michigan State Bankers' Association in 1907, he took occasion to observe:

> The experience of the department shows that it takes years to make a thoroughly competent examiner even when his previous experience has been along the line of bank work, and each succeeding year's work in the service adds greatly to his efficiency.

It is the belief of the superintendent of the banking department of Ohio that

> The work of the department should be so quietly done as to be unnoticed, and that the better its work, the less will be heard from it.

The commissioner of the State of Idaho well describes a certain phase of the work of an examiner in the following language:

> The duties of an examiner are of such a nature as to require men of ability and fitness. Because the duties of an examiner are of a confidential nature and he cannot submit himself to newspapers' interviews, the general public knows very little of his work unless there is a failure in his state, the whole community is then ready to tell how the examiner was incompetent and that the bank should have been closed long before. They do not know of the many special reports and efforts that have been put forth to save the institution, nor do they ever hear of the numerous banks that are saved in this way from failure.

The state examiner of the State of Washington says that

> The state banking department here is conducted along as rigid rules as we know how at the present time, and that we regard our examiners in the same class as the national examiners of this state, and that the examiners here are equal to the best. We are working in perfect harmony with the national department so that all information gained by one department of interest to the other is exchanged.

Compensation of Examiners

The state examiners as a rule receive salaries in addition to their actual traveling expenses, while the national bank examiners receive a graded fee for the examination of each bank, out of which they must pay for such assistants as they require and also all traveling and other expenses.

The salaries of the state bank examiners, with few exceptions, range from $1,200 to $4,800 per annum, many of them working hard all the year, and nearly every day in the year, for the small annual sum of $2,000.

The total amount collected from national banks and paid to the examiners for the last year was $510,928.07, or an average of about $5,000 to each, but by far the larger number receive less than this average. The Deputy Comptroller submitted to the Monetary Commission the following table of amounts paid:

GROSS INCOME OF NATIONAL BANK EXAMINERS.

14	receive over	$2,000	but less than	$3,000
18	receive over	3,000	but less than	4,000
30	receive over	4,000	but less than	5,000
13	receive over	5,000	but less than	6,000
6	receive over	6,000	but less than	7,000
2	receive over	7,000	but less than	8,000
2	receive over	8,000	but less than	9,000

The New York and Chicago examiners not included in this table receive between $18,000 and $19,000 each. Out of their gross income all examiners must pay their own traveling expenses, assistants and other expenses, amounting to about one-third of the total compensation, so that the net income in most cases is very small in proportion to the responsibility assumed.

Character of Examiners

Fully appreciating the honesty and strength of character possessed by bank officers and clerks as a class, it is to be most deeply regretted that exceptions to the general rule exist among them. While the thoroughly efficient examiner preserves an attitude of belief in the honesty of all the bank men met during the performance of his duties, he must be ever alert to detect the acts of the unfortunate and misguided man who has fallen a prey to temptation. Such men are constantly studying ways and means of covering their embezzlement, becoming in some instances experts in concealing traces of their guilt.

An examiner can spend usually not more than a few days each in the examination of a large bank and rarely more than one day each in the banks in smaller cities and towns. Much routine work must be done in this short time to cover the requirements of the state or national regulations, and some examiners unwisely yield to the impulse to fall into ruts of clerical performances not conducive to unearthing well-covered stealings.

The bank man whose accounts are crooked watches the exam-

iner closely, studying every move, that he may know wherein the least danger of discovery lies. He knows exactly where the needle in the haystack is, while the examiner does not even know that there is a needle in the haystack at all. If the examiner paws over the surface of the stack with regular motions at each visit, the guilty possessor of the secret knows where the needle may be buried with least danger of discovery.

The examiner must keep in mind that, while by far the greatest majority of bank men are thoroughly honest in word and act, there may be some men among them guilty of as yet undiscovered fraud. The examiner should study the general subject of fraud in banking thoroughly. One bank cashier says that his experience shows that "*the most usual causes (of fraud) are the following: First, one-man banking; second, corrupt politics; third, excessive loans to directors.*"

The examiners who understand their duties and perform them faithfully are well respected by the bank officers. A vice-president of a large national banks says:

> In a banking experience of forty odd years in a New York City national bank I have been present at every examination except three made by national bank examiners and committees from the board of directors. I think I know all the tricks and possibilities of the business and for the life of me I could not improve on the examinations I have witnessed.

Some examiners go more deeply into the affairs of the bank than others, but none of them pretend that their examinations are as thorough and searching as they would be if the conditions under which such examinations are made were different, and they were afforded more time and assistance. The present comptroller is making earnest efforts to improve the efficiency of his staff of examiners; and, so far as can be learned from the reports of the various state banking commissioners seen, they all realize the need for improvement and are striving to purge the service of weak examiners and at the same time increase the ability of the good man.

The success of an examination depends so much upon the good judgment of the examiner that it is absolutely impossible for the state or national authorities to formulate rules for the conduct of an examination to the extent that mere following of the rules will produce good work. Each good examiner works along his own line of investigation in digging under the surface of things as they

appear, while following a general plan laid down by his superiors framed to verify so far as possible in a short time the existence of the assets and liabilities of the bank as shown by its books.

While some of the bank examiners are men of training and good judgment, and are persistently faithful in their work, others have fallen into a routine performance of their duties calculated to enable them to finish an examination and make a complete report to their superiors in what they think is a reasonable time. It is to be regretted that such work results in a superficial view of things too often expressed in stereotyped language in the reports. As one experienced state banker expresses it, "The principal weakness in the present system of state bank examination appears to me to be a lack of thoroughness and a disposition to only examine surface conditions." He goes on to say that he thinks this "is caused not by the incompetency or unwillingness of the examiners themselves, but by the fact that they have so many institutions to examine that it is really impossible for them to furnish anything but a tentative examination."

Much thought and inquiry outside of the actual work in the bank is undertaken by all good examiners. As an example of the industry and effort on the part of some examiners and the extent to which their labors lead them, the Philadelphia National Bank Examiner, an able man, has taken a step in the obtaining of information which places at his disposal very valuable data. He has inaugurated a credit ledger in his office which contains the names of about 800 of the larger mercantile and manufacturing concerns in the Philadelphia district. It is intended that a letter will be mailed each month to all of the banks in his district, requesting them to furnish the amount of the loans to each and all of the 800 concerns on a given day. This information is to be written in his credit ledger and he can at any time turn to this ledger and ascertain the borrowing of any one concern in all the banks in the district, and any bank in his district can obtain the information by inquiry of the examiner. In a very comprehensive way, he has thus started what may eventually become extended into a very comprehensive credit bureau.

Improvements in Existing Laws Suggested

There is hardly a bank commissioner in any of the states who does not in his reports recommend changes in the laws governing the business of banking and its supervision by the state authorities. There is a general tendency in the state legislatures to adopt the suggestions of the commissioners to the effect that restrictions may be placed on certain banking practices, particularly upon the limit of the loans. In Idaho, for example, it is proposed to pass an act reducing the amount that may be loaned to any corporation or person from fifty per cent to twenty-five per cent. The state bank examiner of South Carolina recommends that he be given authority to direct the charging off of worthless paper stating that

> There are a number of banks perfectly sound and solvent, that are carrying varying amounts of worthless paper, publishing same as good, live assets. They have ample profits to take care of these worthless notes and should be compelled to do so and discontinue the making of misleading reports to the public.

The various comptrollers of the currency, the national supervisors, have suggested improvements in the national bank acts. Perhaps one of the most interesting documents relating to examinations is one published this year, No. 404 of the National Monetary Commission, containing "Suggested Changes in the Administration Features of the National Banking Laws." Recommendations are made by national bank examiners, clearing house associations and state banking officials throughout the United States. There are also the statements made at the hearings of the commission by the Secretary of the Treasury, Comptroller and Deputy Comptroller of the Currency, and the presidents of several national banks. Many different views are expressed in these suggestions regarding certain features of the laws pertaining to the examinations of national banks.

The following is a list of some of the questions propounded by the commission together with a summary of what appears to be the preponderance of opinion in the answers to each:

> 1. Section 5240 of the Revised Statutes authorizes the Comptroller of the Currency, with the approval of the Secretary of the Treasury, to appoint suitable persons to make examinations of national bank associations.
>
> Should, in your judgment, the method of appointing examiners be continued as at present or be made subject to civil service rules?

Is it desirable to apply civil service regulations to the tenure in office of bank examiners?

Eraminers should be appointed by the comptroller without regard to politics, but with regard to special fitness, the comptroller to take the advantages of the civil service examination if it would be of assistance in selecting a candidate. The examiner should be kept in service during faithful performance of his duty, but should be removable by the comptroller.

2. The same section of the Revised Statutes, 5240, provides the method for paying examiners, basing it on the fee system.

In your judgment is it desirable to change this to a salary or per diem basis, to which there should be added the necessary expenses incurred in making examinations, it being understood that banks shall be assessed to pay salaries and expenses in a similar manner as now provided for by the existing law?

The examiners should be placed on a graded salary basis with allowance for actual expenses. The fee system tends to produce superficial work, creates routine performance and, in an effort to save expense, the country bank examiner pursues the same route and can easily be traced by banks in the localities in which he is working; thus banks are able to calculate about when the examiner will arrive.

3. In making assessments to provide a fund to pay examiners and other expenses, do you think the law should be changed so as to base the amount of this assessment on capital and gross assets rather than on capital alone, as the law now provides?

Fees for examination should be based upon gross assets as the fairest method of indicating the amount of labor performed.

4. Do you think it would be desirable to provide a force of assistant examiners to work in co-operation with examiners in large places, and, in future, when vacancies occur, to recruit the force of examiners from these assistants?

This would be a wise provision in order to train examiners, but the comptroller should not be required to select solely from this class in filling vacancies in the position of examiner.

5. As examiners are frequently in charge of failed banks, acting as temporary receivers, do you think it would be desirable to require them to give

a sufficient bond for the protection of the government and the bank when such contingencies occur?

Few seem to think that bonding of examiners is necessary, but most were inclined to agree to the proposition, if desired by the comptroller for any reason.

11. Under Section 5211 of the Revised Statutes, which provides for bank reports, banks are not required to make them in duplicate, and in several instances the examiner has been furnished by the officers of the bank with a report entirely dissimilar from the one on file at the department in Washington, and, in using the imperfect report, he has found that the bank's books correspond to it. This permits of deliberate falsification of accounts.

Would it, in your judgment, be wise to require that reports be made in duplicate, both reports being sent to the Comptroller of the Currency, and one copy furnished to the examiner by the comptroller when about to undertake the examination of the bank?

While some views were expressed dissenting from the thought that the banks be required to issue duplicate reports for the convenience of the examiner, most of them seem to acquiesce in the evident desire on the part of the comptroller that duplicate reports should be sent to him, one of which could be used for the purpose of examination by the examiner.

14. Section 5209 of the Revised Statutes makes it a misdemeanor for an officer or an employee of a bank to make false entries with intention to deceive, but the courts have decided that this does not apply to reports made to the Comptroller of the Currency, as he is not mentioned in the law.

Should not the law be extended to apply to false reports made to the comptroller?

There seemed no doubt whatever that the false entries made in reports to the comptroller should be subject to the same penalty as though made to deceive any other person.

19. Have you any suggestions to make relative to changes in the organization of the comptroller's office? There are many other minor changes which it is apparent should be made in the administrative features of national bank laws, some of which may occur to you, and the commission will be gratified if you, in answer to the above questions, will make any recommendations which seem to you wise, giving your reasons for urging such changes.

There did not seem to be any dissenting voice against the placing of more power in the hands of the comptroller in the enforcement

of the national bank act by penalties not now provided. Under this heading some suggestions are offered regarding the appointment of a supervisor and commissioner in different districts to supervise the work of the examiners. Some recommended the changing of the examiners frequently, and others opposed the view on the ground that an examiner can do better work in banks where he handles the assets several times per annum.

Suggestions for Improving Official Examinations Under Present Conditions

The able examiners are not waiting for changes in the laws to give them more opportunities for better work. The good men are making the most of conditions as they find them. Anything short of unstinted praise in appreciation of the good work such examiners are doing would argue ignorance on the part of the critic. The points brought out in the following paragraphs are not intended as indicative of any shortcomings on those who are doing the best they can under the very trying circumstances in which all examiners are placed. The discussion is intended, first, to state a few of the defects existing in some banks, the presence of which the banks themselves ought to guard against; and, second, to make some kindly suggestions to the less experienced examiners who may desire to improve their efficiency.

There are very few cash items that have any proper place in the settlement of the cash at the end of the day. Too often, however, the "Cash Item" list is used for careless and slovenly banking. At the settlement hour, every check, note or draft should have been disposed of in the regular routine of the business. It sometimes happens that a check will come into the bank too late to put through the day's work. Such an item constitutes a permissible "hold over," but these items should be closely watched and it should be insisted that the amount be reduced to the absolute minimum.

While speaking of cash items, I am reminded of another fruitful source of temptation to the teller in some banks where protested notes and checks are allowed to remain in the control of the tellers. In one case a bundle of such was discovered, some of the protested checks bearing dates for days, months and even years prior to the date of examination.

The examiner frequently meets with a settlement of cash to a penny and is apt to consider the teller very accurate in his work. Sometimes the teller will say that he has "settled" for over a year. The wary examiner will look around for an "over and short" box before giving the teller full credit for what may be justly his due.

Unless examiners have been experienced tellers prior to their appointment the actual work of counting the currency and coin will be necessarily slow. The embarrassment created by the awkward handling of the cash by the examiner in the presence of the skilled teller operates sometimes to prevent a thorough proof of the cash, especially when the hour is getting late and the tellers and clerks are gathered around the examiner watching him with scarcely concealed contempt and sometimes audible sarcasm. Quick handling of the cash comes only after years of practice, and constitutes the chief difficulty that a bank examiner, otherwise brilliant, has to overcome.

Occasionally large loans in the form of checks are carried as cash items. As a rule such loans are intended to remain in the bank over night only, they being taken up or put in some other form the next day. Sometimes they are carried indefinitely, a new check being made out to take the place of an old one when the bank examiner comes around. This is one of the most easily misunderstood things that an examiner has to examine, and he may be of help in keeping the cash clear of such items by explaining to the directors and officers the undesirable features of the bad practice.

Dishonest cashiers and tellers sometimes carry their own borrowings as cash items, until the examiner comes around, when the amount of such items is charged up to various depositors' accounts, until the examiner leaves. The amounts then are either left as fraudulent charges in the depositors' accounts, or returned to the cash items. This can be easily accomplished unless the examiner is alert to locate the cash items at once on beginning his examination. He should very carefully scrutinize all the entries in the check and deposit "scratchers" for at least several days back and endeavor to verify the correctness of the charges and credits by comparison of the entries with the checks paid and deposit slips.

In examining the deposit ledger, he should keep in mind the possibility of entries in the accounts placed there temporarily to

straighten out the cash items or other shortage. In one case, an examiner in taking off a trial balance of the deposit ledger noticed an overdraft of $1,700 apparently made good by a deposit several days prior to the date of his examination. He called for the deposit slip, but it could not be found; and the examiner, after a little more inspection, confronted the cashier with his suspicion that the credit entry was a false one and had been made in the account since the beginning of the examination. While the examiner was in the bank, the cashier had slipped out and exchanged his $2,000 promissory note for that of a friend, which note he placed to the credit of the depositor whose account showed a false overdraft.

Holding back credits for remittances and deposits is a method adopted by some erring bank tellers to cover peculations. Special care on the part of the examiner should be exercised to prevent such practices because when once started, the risk of detection by the ordinary examiner is very small. He will, if careful, watch deposits being made until he has settled the cash and try to keep track of them to the extent that while he is in the bank the entries for these credits will not be omitted from the proper books or records. Otherwise he may count cash, the amount of which has not been entered into the day's business, the cash being handed to him to cover a shortage.

In cities where there are clearing houses, the national banks will have at the end of each day large amounts of checks received during the day to go to the clearing house the next morning. These are, so to speak, "legitimate" cash items, but they should be carefully scrutinized in order to detect false items.

Trust companies usually send all of the checks received by them during the course of the day to their depository, usually a nearby national bank. The pass book of the national bank showing the account with the trust company should, of course, be balanced at the close of the day on which the examination is made.

The general tendency among bank men to-day is toward the desire for ever increasing efficiency on the part of the examiner. With but few exceptions, they urge careful, conscientious work and recommend that nothing be taken by the examiners for granted. "All obscure or irregular matters should be verified or traced to their original sources," is a suggestion made by one of my friends. It expresses a thought that ought not to be lightly treated by an

examiner. Of course it is one that is carried out earnestly by the good examiners.

Another suggestion offered by the same friend is not usually thought of as feasible in the official examinations of state or national banks: "All assets," says he, "should be appraised by competent and expert appraisers and the attention of the management called to doubtful or unknown values." The examiner should endeavor to ascertain the value of every kind of asset, owned by the bank or held as collateral, and very little difficulty is presented in the readily marketable securities constantly quoted. While it may not be feasible at the present time for the national or state examiners to actually put values on all assets, it can be accomplished in the unofficial independent examinations by certified public accountants whose time limit for the examination can be arranged according to the necessities of the case.

One of the most important departments of a bank or trust company consists of its deposits. The verification of the accuracy of the books of the bank in this particular can only be accomplished upon a comparison of the bank's books with the depositors' pass books. It is usually so difficult to obtain the pass books during a short examination that this verification is rarely undertaken in the official examinations. This can be attended to by the clearing house examiner. I know of one at least, who deems the matter of great importance and who calls for a large percentage of all the pass books in each bank. Fears of a run on the bank by excited depositors has in the past operated to create great but natural stubbornness in bank officials against the attempt by examiners or accountants to get in pass books. In an experience including several sad cases of trouble the author has found that the bulk of the amount of the embezzlement was revealed when the depositors' pass books were examined.

One bank cashier states the matter very clearly in the following suggestion:

> Examiners are particularly careful with the correspondent banks, why not with the individual? I have always thought it would be wise for an examiner—he is always with a bank several days—to send for such pass books as he may think advisable in scanning the ledgers and settle them while at the bank, having the balance checked up afterwards with the depositors in the same manner as he checks up with the banks. If the dishonest teller or bookkeeper knew this to be a general practice, he would

be very loath to manipulate figures, either in deposit slips or posting. The examiner may argue that he has not the time for exhaustive examinations, but the moral effect of even a slight effort in this direction, would, I think, be very beneficial.

The suggestion is put in another way by another bank cashier:

There appears to be abundant room for fraud by collusion between a teller and a bookkeeper in making false charges to cover shortages in cash. For this reason we can see that the accounts of the individual depositors ought to be verified by direct communication of the auditor or examiner with the depositor.

A trust company's treasurer goes a step further and recommends that the

Department should require its institutions to adopt a system whereby their pass books are settled periodically, a receipt containing a clause to the effect that the pass book has been received and verified, obtained from each depositor, or the settlement of pass books eliminated and a system of rendering accounts at stated periods adopted.

Here again is evidence of a dividing line between what the official examiner believes is the limit of his duties and what in his opinion ought to be attended to by the bank itself with or without the assistance of certified public accountants, who may, if employed, easily obtain the proper verification, providing the banks want a thorough examination and if the way in which the examination is carried out is tactful and persistent. Honest and entirely trustworthy bank men commend acts of precaution as evidences of that care upon which they in many cases rely as a safeguard against the embezzlement by their clerks.

One of my friends expressed himself very strongly on the subject. It is to be hoped that the suggestion applies only to some exceptionally careless examiner: "In all examinations and until the assets have been verified, the officers of the institution should have access to the assets only when accompanied by the examiner. This practice which is customary with certified accountants is neglected by the authorities of this state, and this oversight could easily be used by unscruplous or dishonest officials to their own advantage."

Perhaps all of my readers know that the trust funds of a trust company are not included in its statement of final condition. If mentioned at all, the notation is usually made at the bottom of such

statement and is confined to the amount of trust funds invested and uninvested. The suggestion is that there should be:

> An appreciation of the necessity of better examinations of the enormous assets and liabilities held by the trust companies in fiduciary capacities. This neglect has probably arisen from the fact that most of the older institutions to-day conduct this department of their business by single entry system of bookkeeping. Such make lapsed and complete audits almost impossible.
>
> These trust assets and liabilities in many cases far exceed the total resources of the company and should be subject to careful and rigid verification.

The official examiner in some cases perhaps works too exclusively with the bank's own statement of its financial condition for his guide. There are many assets in a bank besides those appearing in the statement. Two of this character, the examination of which would operate as a safeguard against stealing, are expressed by the vice-president of a large city bank who recommends:

> (1) The more careful auditing and verification of stocks, securities and valuable papers left with the bank for safekeeping; and
>
> (2) Also a more thorough system of recording and verifying loans made on account of out-of-town correspondents. These are two weak points and should be carefully guarded by all of the banks handling this class of business.

From the official examiner's standpoint, such matters ought to be safeguarded by the banks themselves. He has his hands full in the verification of the assets and liabilities as shown by the bank's statement. If he can satisfy himself that the bank is in good condition and is not badly violating the law, he considers that he should not be required to try to find any other assets of the sort referred to. There is no doubt that the points raised by this bank official are highly important and they should be provided for in some way or another. The good examiner is fully aware of the possibility for manipulation in that kind of assets and he has not only the knowledge that the securities might be easily stolen by the dishonest clerk or official in charge of them, but he knows also of the opportunity for making these securities do the duty of taking the place of the bank's own missing securities and collateral.

That fictitious promissory notes have been prepared to deceive the examiners is a fact known to many examiners, and to bank men as well. One cashier has urged the importance of verification

of these notes in the following words: "All the discounted paper of the bank of any large amount (which is of course counted in the assets) should be known to be genuine."

The official examiner will say on this point that it is absolutely impossible for him to know the signatures of even the large borrowers in the banks. He can overcome part of the difficulty by calling in a committee of the directors of the bank to assist him in his scrutiny of the signatures, but in many instances the bank directors would not know as much about the signatures as the examiner himself, although a stranger to the borrowers. Perhaps the best way of verifying the genuineness of notes is by correspondence with the borrowers. The bank examiner has the right and power so to do, and some of them partially exercise that power. If a borrower admits directly to the examiner his liability, it is the best evidence that his note for the amount is at least genuine.

In large banks and trust companies a daily statement of the resources and liabilities is usually prepared each morning for the information of the officers and directors and is usually found in the possession of one of the officers of the bank or trust company, as the case may be. The treasurer of a large trust company makes a pertinent suggestion on this point:

> I have noticed that the city and state examiners as well as C. P. A's. all uniformly seem to ask the first thing on an examination for a copy of the daily sheet as it appears, each morning, on the president's desk. This copy may be made up by the general ledger bookkeeper, and I have never seen but one man compare it with the actual figures on the president's desk, which are of course made up by some one other than the general ledger bookkeeper. There seems to be a chance for the general ledger bookkeeper to make up a false copy of the president's sheet to agree with a falsified account of the general ledger.

A trust company treasurer with full knowledge of the handicapping conditions under which the examiner labors, says he believes that if the examiners

> Were instructed to thoroughly examine one feature of an institution at each examination, choosing a different feature each time, that the present system would be much more efficacious. So many examinations merely consist of counting the cash, not very thoroughly, checking off securities, mortgages and other assets with the general balance sheet and taking a balance sheet from the individual ledgers. How much more effective it would be if a part of the time so spent were devoted to thorough analysis of the

institution's accounts with other institutions, or the verification of a large number of pass books or in the checking and verification of earnings received or due.

In many bank statements important items consist of accrued interest on investments and loans, considered as assets, and of accrued interest on deposits considered as liability. A large number of banks, both state and national, ignore these figures in their statements on the ground that the labor of keeping the amount calculated up to date is greater than the advantage to be obtained in setting them out in the statement. The treasurer of an active young trust company said the other day:

I believe that the system of accruing interest would be an important help to the examiner in making a quick verification of earnings as a whole. It is a simple matter to at least approximate the proper amount of earnings accruing, say each month. On the other hand, should this system not be used, an examiner cannot even approximate earnings, but must perforce check the entire sources of earnings in detail, which very few of them would have time to do.

The verification of the various income accounts to ascertain that all of the income from the assets of the bank, and from its services rendered in various forms, have been properly accounted for should surely be undertaken by some one. That some test at least along these lines should be made by the official examiner, there seems to be no doubt. One bank cashier expresses this thought as follows:

As to the income, very serious leakages sometimes occur if the items of interest, discount, etc., are not properly double checked, and a sort of verification of the work done in this department should be required in every thorough bank examination.

Another bank official, urging that the income be checked, says: "It is doubtful if the safe deposit departments of most institutions are ever subject by state authorities to verification with general books."

Examinations by Certified Public Accountants

It has been shown that with few exceptions, most state banks, trust companies, saving banks and national banks are examined at least once a year. In many states two examinations are required, in some states the number of official examinations is even larger. The

national bank examiners make, as a rule, about two examinations each year. It has also been shown, I think, that the bank examiners, and bank men realize that while some improvements can be made, even under existing conditions, the scope of the official general examination is more or less limited.

In my opinion, the best results could be obtained from official examinations if all the examiners were placed upon a salary and expense basis and a plan worked out by which frequent visits could be made to the banks during the year, at which time some one or more departments of the bank could be thoroughly examined, to the end that during each year the entire ground will have been covered more thoroughly than is possible under the present arrangement. To bring about this change in the methods, a change in the national bank law and in those of many states would first be necessary. In the meantime, and until some such plan is put into effect, I think that the banks generally ought to exercise more general supervision over their own institutions, and employ certified public accountants as far as needed to make the supervision effective.

One form of self-examination has been adopted by several of the clearing house associations in the large cities. Under this arrangement a special examiner is appointed to examine thoroughly the banks in the association. The examiner receives a fixed salary and his assistants are paid directly by the association, so that he has no handicap in the matter of compensation and is free to spend as much time in each bank as he desires, the only limitation being that he must examine each bank once during each year. His reports are made in duplicate, one going to the bank examined, and the other being filed by him in the clearing house vault. The copy of his report on file is not accessible to any person whatever, except the clearing house committee and then only in such cases as he deems are of enough importance to call to the committee's attention.

The present examiner for the Philadelphia Clearing House, was, until recently, a national bank examiner of high character and enviable reputation. He finds time now to go into many details of importance that were obliged to be omitted in the official examinations. More than one matter of consequence has been discovered by him in his capacity as special examiner that could not reasonably be expected to be unearthed by the regular examiner for the government. In speaking of his examinations one of the cashiers said:

The most complete and effective examinations ever made of this bank were inaugurated by Mr. W. M. Hardt, the examiner for the Philadelphia Clearing House Association, who with his assistants (five competent ex-bank clerks) will take charge of any bank in the association about the closing hour, three o'clock P. M., make the settlements complete of both tellers' desks, seal the vaults with all bills receivable and securities; and the next day prove by going over all bills separately, and taking each of the collateral loans for separate examination and market value of said collateral; putting his assistants on the individual ledgers, sending for pass books and proving at least fifty per cent of all accounts and likewise of the general ledger accounts, with all correspondents; including the postings of said ledger for numerous back dates or taking all postings for the pending month. *In fact, to supervise the running of the bank for at least eight or ten days.*

Banks are now having enough official general examinations of the kind possible to be made under existing laws. While some examiners are fully, conscientiously and ably performing their duties there are others whose performance is too clerical in character. Taking the best work of the best examiner as a standard, there is yet room for useful service by certified public accountants in the supervision of the operation of many banks. No arbitrary plan for the examination of all banks can be prepared. The services of outside experts should in each case be arranged to fit the particular requirements of each bank, taking into account the amount and quality of the supervision made by the bank itself.

The frequent visits that can be planned with the opportunity of close study of the bookkeeping transactions and the verification of many things not easily overhauled by the official examiner under present conditions, would be of benefit to all banks excepting, perhaps, those banks which are conducting thorough self-examinations. The visit to a bank at least once each month by a trained expert whose mind is set upon the performance of his duties in such a manner as to be most helpful to the clerks, officers and directors, can scarcely fail to be of benefit to the bank.

STATE AND FEDERAL CONTROL OF BANKS

By Andrew J. Frame,
President, Waukesha National Bank, Waukesha, Wisconsin.

It is of inestimable value to the public to have good laws regulating the banking business and providing, among other things, for examination of all banks by duly appointed competent examiners to see that the laws are complied with. Notwithstanding this there is an apparently honest minority who prefer entire freedom in their banking methods. Let us very briefly diagnose the case to see if free banking is really an open question.

It would seem that a few summarizations from the best authorities would suffice. John J. Knox in his "History of American Currency" refers pointedly to the smaller losses to depositors in states having good banking laws, as against states without such laws. His references referred to the days when free banking predominated. I have been engaged in the banking business for nearly fifty years, and the calamitous results to the people in the wildcat days of a free banking system were so impressive that death alone can obliterate their abominations from my mind. The history of banking in all nations is full of facts which seem to cry out for laws requiring stringent examinations.

It is well known to all students that previous to 1900 most of the states had either no laws or indifferent ones regulating state banks. Some states, especially some among the older eastern ones, have long had good laws; and, in those states, the losses to depositors have been proportionately much smaller than in the other states with lax laws or no laws at all.

Results 1863 to 1896

A compilation of the general results of the examination and regulation of banks in the United States is found in the 1896 report of the Comptroller of the Currency, which compares results under the national banking system with those under the several state banking systems. From 1863 to 1896, 330 national banks and 1,234

state banks failed in the United States. The claims filed, dividends paid to depositors and amounts unpaid, were as follows:

	Claims filed.	Per cent paid depositors.	Still due to creditors.
National banks	$98,322,170	63 8/10	$35,556,026
State banks	220,629,988	45 4/10	120,541,262

As further dividends were afterwards paid by banks *not entirely closed,* Ex-Comptroller Ridgely, in 1903, referring to the above report, made this significant comment: "It will be seen that while only six and one-half per cent of national banks in existence failed during this time, seventeen and six-tenths per cent of the other banks in existence failed. And while the national banks which had failed up to 1896 (and were entirely closed) *paid seventy-five per cent* in dividends, the state and other banks *paid only forty-five per cent.*"

Comptroller Murray, in summing up his report for 1909, as to national banks and Bradstreet's report as to state banks from 1863 to 1909, states that 508 national as against 2,014 state banks failed. The percentage of total failures of national banks, 6.5 per cent up to 1896, was reduced to 5.04 per cent in 1909. The per cent of the state bank failures was not stated, but his figures clearly indicate an increase over those up to 1896. Comptroller Murray's 1909 report also shows an increased total percentage paid to depositors of national banks, which indicates greater efficiency in the jurisdiction of the comptroller's office and more conservatism on the part of bankers.

World Comparisons

Supervision of banks, state or national, is very limited in the other progressive nations of the earth. However, the world's bank failures and losses to depositors show conclusively that the national banking system of the United States has proved to be the safest for depositors. Its only material defect is its inelastic methods of issuing currency. Some good men still hold up as better models for us to follow the old state banks of Indiana, Louisiana and others which, although they proved safe, died a natural death largely because of over rigid regulations, under which progress was stifled instead of encouraged. This fact may readily be shown.

State Bank of Indiana

On all applications for loans above $500 a majority vote of five-sevenths of the board was necessary, and the vote had to be entered on the minutes, with the names of the directors voting. Directors were individually liable for losses resulting from infraction of the law, unless they had voted against the same and caused their vote to be entered on the minutes, and had *notified the governor of the state* of such infraction forthwith, and had *published their dissent in the nearest newspaper.* Any absent director was deemed to have concurred in the action of the board, unless he should make his dissent known in like manner within six months.

Louisiana Bank Act of 1842

First. One-third of all liabilities must be in specie.

Second. The other two-thirds in not over ninety-day paper.

Third. All commercial paper to be paid at maturity and if not paid, or if an extension were asked for, the *account of the party to be closed and his name sent to the other banks as a delinquent.*

With such ridiculous methods our present progress would be palsied. To require to-day for all banks in the United States $33^1/_3$ per cent of all liabilities in coin, as against individual deposits alone of 14,000 millions of dollars, would lock up 4,600 millions of dollars in specie; whereas banks now hold about 1,100 millions of dollars in specie.

The free coinage of silver is out of the question, and the world's stock of gold is in active demand. Where would the gold come from to carry out the provisions of the Louisiana bank act?

European Experiences

Owing undoubtedly to a single bank of issue in each nation, standing like a great water reservoir to quench a general conflagration, the banks generally there hold about one-half the coin reserves held by the banks in the United States; yet the institutions of Europe have not suspended cash payments for fifty years, as we did to our great dishonor in 1907 and not quite so generally in 1873 and 1893. To provide a currency system which will prevent suspension of cash payments by banks generally in the United States, and which will tend to prevent calamitous results therefrom, is the paramount question for us to solve; but. in Europe, the failure to adequately regu-

late banks by law and properly to supervise them by competent authority has thrown an unnecessary burden upon stockholders and depositors of banks during the past fifty years. This is well illustrated by the City of Glasgow Bank.

Glasgow Failure

The City of Glasgow Bank with 131 branches, under freedom of banking, failed in 1878 for $70,000,000. Its losses were $35,000,000, which sum is about equal to the total losses to all the depositors of the vast regulated national banking system of the United States from its inception in 1863 to the present date. That loss was shouldered by the large list of stockholders of the Glasgow bank, under the then "unlimited liability act." This act cost one stockholder, holding but £1,000 of stock, his whole fortune of £1,000,000. The American Encyclopedia says "because of the widespread holdings of the stock of the bank, the failure amounted to almost a national disaster." This failure seems to show that it is sometimes better, as under our independent banking system, "to hang separately than to hang together" under the branch banking system.

The "unlimited liability" act has in consequence of the terrible results been suspended, and now holds good only in voluntary cases. To avoid unlimited liability, the word "limited" must follow any corporate name. I might cite other calamitous conditions which occurred in 1836, 1847, 1857, 1866, 1878, and 1890, in Great Britain, and the failure of "The Credit Mobilier" in France; but it seems superfluous. I have no doubt that such distressful conditions would have been greatly ameliorated if good laws and examinations had been in force.

In view of the fact that most of the states, up to ten years ago, permitted entire freedom in banking methods, it is cause for congratulation that great progress in regulation has been made in many states. This fact is clearly shown in the late report of a special committee on banking in Wisconsin. The report shows that state laws require that

(1) Directors must examine banks in twenty-one states.

(2) There is special bank supervision in thirty-five states.

(3) Some state or other official shall examine banks in thirteen states.

This report states that nearly every state in the United States now has some kind of laws regulating the banking business, and, that many of the state banks are subjected to examinations. Our defective currency system caused many bank suspensions in 1907; yet, because of the marked improvement in banking laws, and in supervision, most of the suspensions were temporary. The losses to depositors also were far less than in the past under free banking. The fact that more than one hundred millions of dollars was locked up, in 1907, in suspended banks in New York State, and that not a dollar was lost to a depositor, is evidence that New York State now has good banking laws. Some state laws are still too lax, and all should be so modified as to comply with the best laws regulating eastern savings banks and trust companies. The state banks doing largely a commercial business should be compelled to follow closely the requirements of our most beneficent national bank act. The Wisconsin law is a good model for state banks, as not a dollar has been lost to a depositor since the law was enacted about six years ago. This law is modeled largely upon the national bank act; but is more liberal as to the percentage of loans to any person or firm. This provision, owing probably to excellent supervision, has produced no ill results. To my mind, however, the national law is the better of the two.

It is the clear duty of the legislators of Europe to the people as a whole to regulate reasonably the great banking systems there, that losses to innocent depositors may be limited to the lowest point compatible with the fact that perfection is impossible and that the millenium will never be attained on earth.

The meat of the whole matter lies in passing good banking laws and enforcing them by strict examinations, in closing up the insolvent banks and not allowing them to dissipate good assets for years after becoming insolvent under incompetent or dishonest mismanagement. The banking power of the United States is about two-thirds that of the rest of the world. We should give the twenty-five million depositors having 14,000 millions of dollars on deposit—both growing constantly—all the protection wholesome laws can give. By limiting bank failures, panic conditions and general commercial distress will be ameliorated. Good banks generally court investigation, and the people should insist on rigid control of all banks for the purpose of weeding out those which are insolvent.